

**DIGEST OF DIFFERENCES BETWEEN
ADMINISTRATIVE LAW JUDGE KIMBERLY KIM'S REVISED PROPOSED
DECISION AND THE ALTERNATE PROPOSED DECISION
OF PRESIDENT MICHAEL R. PEEVEY**

ATTACHMENT

Pursuant to Public Utilities Code Section 311(e), this is the digest of the substantive differences between the revised proposed decision of Administrative Law Judge Kimberly Kim (mailed on April 18, 2014) and the alternate proposed decision of President Michael Peevey (mailed on April 24, 2014) in the matter of Application 12-12-024, Application for Authority to Increase Rates and Charges for Gas Service in California, Effective January 1, 2014 (Application), filed on December 20, 2012, by Southwest Gas Corporation (Southwest Gas or Company).

The pending revised proposed decision (PD):

- Adopts the proposed rate increases requested in the Application for Authority to Increase Rates and Charges for Gas Service in California, Effective January 1, 2014 (Application), filed by Southwest Gas Corporation (Southwest Gas or Company);
- Adopts an attrition rate of 2.95 percent;
- Authorizes \$13,790,687 for Federal Energy Regulatory Commission (FERC) Account 921, which is based on the 2011 balance.
- Authorizes increases in the Company's base revenue requirement for test year 2014;
- Authorizes, *inter alia*, two safety programs, including a mechanism for cost recovery: (a) the customer-owned yard line (COYL) program, as a pilot program for the current general rate case cycle; and (b) the accelerated replacement of Aldyl-A (AA) pipe in South Lake Tahoe;
- Directs Southwest Gas to prepare, in cooperation with Office of Ratepayer Advocates (ORA) and Safety and Enforcement Division, and submit Customer Owned Yard

Line (COYL) Pilot Program implementation plan, including budget, within 90 days; and

- Denies a one-way balancing account proposed by ORA for pension expenses and approves two-way balancing account instead.

The alternate proposed decision (ADP) differs from the PD in several respects summarized below, and the APD:

- Adopts an attrition rate of 2.75 percent;
- Authorizes \$13,266,834 for FERC Account 921, which is a five-year average balance from 2008-2012;
- Modifies the Company's request for the COYL program to include only leak surveys for the proposed 259 schools, and reduces the related revenue adjustment mechanism to \$8,648; and
- Denies the Company's request to accelerate AA pipe replacement in South Lake Tahoe jurisdiction.

Aside from the above noted differences, APD does not differ from PD.

(END OF ATTACHMENT)

COM/MP1/sbf **ALTERNATE PROPOSED DECISION** Agenda ID #12965 (Rev. 2)
Alternate to Agenda ID #12646
Ratesetting
6/12/2014 Item 57a

Decision **ALTERNATE PROPOSED DECISION OF PRESIDENT PEEVEY**
(Mailed 4/24/2014)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southwest Gas Corporation
(U905G) for Authority to Increase Rates
and Charges for Gas Service in California,
Effective January 1, 2014.

Application 12-12-024
(December 20, 2012)

**ALTERNATE PROPOSED DECISION ADOPTING TEST YEAR 2014
GENERAL RATE INCREASES FOR SOUTHWEST GAS CORPORATION'S
SOUTHERN CALIFORNIA, NORTHERN CALIFORNIA AND SOUTH LAKE
TAHOE RATE JURISDICTIONS**

Table of Contents

Title	Page
ALTERNATE PROPOSED DECISION ADOPTING TEST YEAR 2014 GENERAL RATE INCREASES FOR SOUTHWEST GAS CORPORATION’S SOUTHERN CALIFORNIA, NORTHERN CALIFORNIA AND SOUTH LAKE TAHOE RATE JURISDICTIONS.....	1
1. Introduction	2
2. Summary of Application.....	3
3. Background and Procedural History	6
4. Evidentiary Standard and Burden of Proof	7
5. Discussion	7
5.1. Rate Base	9
5.1.1. Net Plant	9
5.1.2. Working Capital	10
5.1.2.1. Cash Working Capital.....	10
5.1.2.2. Materials and Supplies	12
5.1.3. Customer Advances.....	14
5.1.4. Deferred Taxes	15
5.1.4.1. Deferred Tax Treatment of Bonus Depreciation and Net Plant Additions	15
5.1.4.2. Deferred Tax Treatment of Net Operating Losses	20
5.1.5. Gross Revenue Conversion Factor	21
5.2. Attrition.....	21
5.2.1. Annual Post-Test Year Margin Adjustment.....	21
5.2.2. South Lake Tahoe Annual Post-Test Year Margin Adjustment for Accelerated Aldyl-A Replacement	25
5.2.3. Phase-in of South Lake Tahoe Test Year Margin.....	26
5.2.4. Victor Valley Transmission System Replacement	27
5.3. Cost of Capital.....	28
5.3.1. Legal Standards.....	29
5.3.2. Capital Structure	30
5.3.2.1. Improved Capital Structure	31
5.3.2.2. Proxy Group Comparison.....	33
5.3.2.3. Relationship to Target Credit Rating.....	34
5.3.3. Return on Equity.....	35
5.3.3.1. Financial Models.....	37

Table of Contents (Cont'd)

Title	Page
5.3.3.2. Comparison of ROE to Other Benchmarks.....	38
5.3.3.3. Overall Rate of Return and Required Return on Equity	40
5.4. Operating Expenses.....	42
5.4.1. Operations and Maintenance Expenses.....	43
5.4.1.1. Distribution Expenses.....	44
5.4.1.2. Customer Accounts Expenses	45
5.4.2. Administrative and General Expenses.....	48
5.4.2.1. Injuries and Damages	48
5.4.2.2. Office and Supplies	50
5.4.3. Pensions and Benefits.....	50
5.4.3.1. Pension and Benefits Accounts	51
5.4.3.2. Flex Benefits.....	52
5.4.3.3. Executive Benefits.....	53
5.4.3.4. Labor Loadings	57
5.4.3.5. Balancing Account for Pension Expense.....	57
5.4.4. Depreciation and Amortization Expense	58
5.4.5. Taxes (excluding Deferred Taxes)	59
5.5. Infrastructure.....	60
5.5.1. IRRAM.....	61
5.5.2. Customer-Owned Yard Line (COYL) Program.....	62
5.5.3. Accelerated AA Replacement	66
5.6. Rate Design.....	67
5.6.1. New Rate Mechanisms.....	68
5.6.2. Upstream Pipeline and Storage Costs.....	68
5.7. Miscellaneous/Other Issues	69
5.7.1. California Conservation and Energy Efficiency Plan	69
5.7.2. Automatic Trigger Mechanism	70
5.7.3. Submetered Discount	71
5.7.4. Results of Operations (RO) Model	71
6. Conclusion	71
7. Comments on Alternate Proposed Decision.....	71
8. Assignment of Proceeding.....	72
Findings of Fact	73
Conclusions of Law	86

Table of Contents (Cont'd)

Title	Page
ORDER 93	
Attachment 1: SWG SoCal Summary of the Authorized Overall Results of Operations	

**ALTERNATE PROPOSED DECISION ADOPTING TEST YEAR 2014
GENERAL RATE INCREASES FOR SOUTHWEST GAS CORPORATION'S
SOUTHERN CALIFORNIA, NORTHERN CALIFORNIA AND SOUTH LAKE
TAHOE RATE JURISDICTIONS**

1. Introduction

This decision approves the proposed rate increases requested in the Application for Authority to Increase Rates and Charges for Gas Service in California, Effective January 1, 2014 (Application), filed on December 20, 2012, by Southwest Gas Corporation (Southwest Gas or Company), as modified. Specifically, this decision authorizes increases in the Company's base revenue requirement for test year 2014, as follows:

- Increase of approximately \$1,872,515 or 1.8 percent from currently authorized revenue in its Southern California rate jurisdiction.
- Increase of approximately \$2,514,501 or 8.4 percent from currently authorized revenues in its Northern California rate jurisdiction.
- Increase of approximately \$2,716,370 or 13.7 percent from currently authorized revenues in its South Lake Tahoe rate jurisdiction.

This decision authorizes the post-test year changes to rates and charges for years 2015 through 2018, to become effective on January 1 of each year, in each of the Company's three California rate jurisdictions. This decision also approves the Southwest Gas proposed Post Test Year Mechanism, adopting an annual adjustment of 2.75 percent, and the Conservation and Energy Efficiency Plan. This decision modifies the proposed Infrastructure Reliability and Replacement Adjustment Mechanism and the proposed Customer-Owned Yard Line Program. The proposed Aldyl-A pipe replacement acceleration is denied.

This decision closes this proceeding.

2. Summary of Application

On December 20, 2012, Southwest Gas Corporation¹ (Southwest Gas or Company) filed an Application for Authority to Increase Rates and Charges for Gas Service in California, Effective January 1, 2014 (Application).²

On October 2, 2012, prior to filing its Application, Southwest Gas tendered its Notice of Intent (NOI) for the Application, and on November 30, 2012, the Commission's Division of Ratepayer Advocates (DRA, hereinafter Office of Ratepayer Advocates (ORA))³ notified Southwest Gas of the adequacy of its NOI and the acceptance of its general rate case submission for service and filing.

The Application⁴ was filed and supported by justifications, points and

¹ Southwest Gas is a multi-jurisdictional public utility, providing natural gas service to customers in California, Arizona and Nevada. Southwest Gas engages in the retail distribution, transportation and sale of natural gas for domestic, commercial, agricultural and industrial uses. Southwest Gas currently serves approximately 1.8 million customers in the states of California, Arizona and Nevada. In California, the Company serves approximately 185,000 customers in three ratemaking jurisdictions: (1) Southern California; (2) Northern California; and (3) South Lake Tahoe. Its Southern California rate jurisdiction comprises various communities and areas in San Bernardino County. Its Northern California rate jurisdiction covers communities and areas in Placer, El Dorado and Nevada Counties, and its South Lake Tahoe rate jurisdiction is entirely within El Dorado County.

² Southwest Gas's Application consists of four volumes, organized as follows: Volume I contains the Application (including proposed notices and the Summary of Changes); Volume II contains the results of operations, and is presented in separate parts (Volumes II-A, II-B and II-C) for each rate jurisdiction. The narrative summaries accompanying each of the Volume II chapters were prepared to provide a general description of the steps taken by Southwest Gas to develop the schedules contained within that chapter. Volume III contains the prepared direct testimony supporting the Application. Volume IV is also presented in separate parts, and contains the supporting workpapers for each rate jurisdiction. Southwest Gas did not file Volume IV, but delivered copies of the same to Division of Ratepayer Advocates.

³ As of September 26, 2013, the governor of State of California has signed Senate Bill (SB) 96, which among other things, changed the name of DRA, to Office of Ratepayer Advocates (ORA). Hereinafter, in this decision, reference to ORA will be used to refer to DRA where appropriate.

⁴ As part of the settlement approved in Decision (D.) 08-11-048, Southwest Gas also provided a retrospective audit report of its Post-Retirement Benefits Other Than Pensions (PBOP) trust

Footnote continued on next page

authorities, testimony⁵ and schedules, claiming that its annual revenue deficiency for Test Year 2014 results in an increase of approximately \$5.6 million for the Southern California rate jurisdiction, an increase of approximately \$3.2 million for the Northern California rate jurisdiction, and an increase of approximately \$2.8 million for the South Lake Tahoe rate jurisdiction.

Southwest Gas therefore requests, effective January 1, 2014, revenue increases as necessary to recover those costs. In the Application, Southwest Gas also seeks approval of its proposed Post Test Year Mechanism (PTYM), an Infrastructure Reliability and Replacement Adjustment Mechanism (IRRAM) and a Conservation and Energy Efficiency Plan (CEE Plan).

Southwest Gas complied with the Commission's Rules of Practice and Procedure, Rule 7.1(a), and in compliance with Rule 3.2(a), Southwest Gas also filed:

- (1) Balance sheets and income statements for each of the Company's rate jurisdictions, as of December 31, 2011, are included at Chapters 2 and 3 of Volumes II-A, II-B, and II-C of this Application.
- (2) Statements of the presently effective rates and charges for each rate jurisdiction are included at Chapter 20 of Volumes II-A, II-B, and II-C of this Application.
- (3) Statements of Southwest Gas's proposed changes to the revenue requirements in each rate jurisdiction are included at Chapter 20 of Volumes II-A, II-B, and II-C of this Application. The statements show the amount of proposed gross revenues, together with the percentage of increase or decrease estimated to result from the proposed rates.

account, in the format proposed by ORA in its Report.

⁵ Pursuant to Resolution ALJ-190, Southwest Gas did not file its testimony, but has served copies to the Chief Administrative Law Judge and ORA.

Additionally, the statements show the proposed revenue increase or decrease, including the percentage of increase or decrease for each rate classification.

- (4) A statement that the property of Southwest Gas is composed of pipelines, valves, meters, regulators, buildings, motor vehicles, construction equipment, office equipment and related property. A statement of the original cost of Southwest Gas's property, together with a statement of the depreciation reserve applicable to the property, and depreciation reserve is set forth in Chapter 17 of Volumes II-A, II-B, and II-C of this Application.
- (5) A summary of earnings on a depreciated rate base for the test period, upon which Southwest Gas bases its justification for the proposed rate changes, is set forth in Chapter 6 of Volumes II-A, II-B, and II-C of this Application.
- (6) The earnings results for Southwest Gas's total natural gas utility operations are set forth in Chapter 3 of Volumes II-A, II-B, II-C of this Application.
- (7) Statements as to: (a) which of the optional methods provided in the Internal Revenue Code Southwest Gas elected to employ in computing the depreciation deduction for the purpose of determining its federal income tax payments; (b) the method utilized by Southwest Gas in calculating federal income taxes for the test period for ratemaking purposes; and (c) whether Southwest Gas has used the same method or methods in calculating federal income taxes for the test period for rate making purposes are set forth in Chapter 16 of Volumes II-A, II-B and II-C of this Application.
- (8) The latest proxy statement sent to Southwest Gas's stockholders is included at Chapter 23 of Volumes II-A, II-B and II-C of this Application.
- (9) The proposed rate changes reflecting and passing through to customers only the costs to Southwest Gas for the

services or commodities furnished by it. Rules 3.2(b) and 3.2(c).

3. Background and Procedural History

In Southwest Gas's Test Year 2009 general rate case (Decision D.08-11-048, rendered in Application (A.) 07-12-022), the Commission approved an all-party settlement which authorized revenue requirement increases in the Company's Southern California and South Lake Tahoe jurisdictions, and a revenue requirement decrease in the Company's Northern California jurisdiction. The settlement also provided for post-test year revenue requirement increases in all three jurisdictions for the years 2010, 2011, 2012 and 2013.

Southwest Gas filed the instant Application on December 20, 2012. ORA filed a late-filed protest on January 31, 2013. A Prehearing Conference was held April 18, 2013 and attended by the Company, ORA and The Western Manufactured Housing Communities Association.⁶

A Joint Scoping Memo and Ruling was issued by Administrative Law Judge (ALJ) Kim and Commissioner Sandoval on May 30, 2013, setting the scope of the proceeding and confirming the procedural schedule established at the Prehearing Conference. After discovery and exchanging written testimony, parties participated in evidentiary hearings from August 12, 2013 through August 14, 2013.

Concurrent opening briefs were filed by Southwest Gas and ORA, on September 19, 2013. Said parties filed concurrent reply briefs on October 1, 2013.

⁶ The Western Manufactured Housing Communities Association made an oral motion to intervene in this proceeding, which was unopposed and granted by ALJ Kim.

4. Evidentiary Standard and Burden of Proof

Under Section 454(a) of the California Public Utilities Code⁷ (Code), a utility shall not change or alter any rate absent a finding by the Commission that the new rate is justified. The burden of proof in ratemaking proceedings rests with the applicant.⁸ The evidentiary standard applicable to this burden is preponderance of the evidence.⁹

5. Discussion

The issues considered here pertain to the establishment of just and reasonable rates that provide Southwest Gas a realistic opportunity to earn a reasonable rate of return, while ensuring safe and reliable natural gas service to its California customers.

Southwest Gas has shown that its annual revenue deficiency for Test Year 2014 results in an increase of approximately \$5.6 million for the Southern California rate jurisdiction, an increase of approximately \$3.2 million for the Northern California rate jurisdiction, and an increase of approximately \$2.8 million for the South Lake Tahoe rate jurisdiction.

Southwest Gas explains these increases are driven primarily by two key factors – a significant improvement in the Company’s capital structure and credit ratings in the years since its last California general rate case, and changes in the Company’s rate base in each of its California rate jurisdictions.

The record in this proceeding, including the written testimony from

⁷ Unless otherwise noted, all references to Code in this decision are to California Public Utilities Code.

⁸ D.09-03-025 at 22. *See also*, D.11-05-018 at 33-34.

⁹ *Id.*

witnesses on behalf of ORA and the Company, multiple schedules for each ratemaking jurisdiction, and testimony and exhibits from three days of evidentiary hearings, demonstrates that Southwest Gas has satisfied its burden, as discussed below.

Based on, *inter alia*, the opening brief, filed on September 19, 2013, by Southwest Gas, which set forth a summary of uncontested issues jointly prepared by Southwest Gas and ORA, we acknowledge that ORA either supports, agrees with or otherwise does not object to many components of this Application.¹⁰ Likewise, based on, *inter alia*, the opening brief, filed on September 19, 2013, by Southwest Gas, which set forth a summary of outstanding contested issues jointly prepared by Southwest Gas and ORA,¹¹ we acknowledge that ORA either opposes, disagrees with or otherwise objects to number of issues raised by the Applications, as follows: (1) Proposed Revenues and Annual Revenue Deficiency, (2) Rate Base, (3) Gross Revenue Conversion Factor, (4) Post-Test Year Adjustments (PTYA), (5) Cost of Capital, (6) Certain Distribution Expenses (\$2011, excluding labor loading), (7) Certain Customer Accounts Expenses (\$2011, excluding labor loading), (8) Certain Administrative

¹⁰ Opening Brief at ix-xiii: (1) Conservation and Energy Efficiency (CEE) Portfolio, (2) Billing Determinants, (3) Class Cost of Service Study, (4) Revenue Allocation, (5) Rate Design, (6) System Allocable Costs Allocation Factors, (7) Escalation and Constant Dollars Factors, (8) Cash Working Capital, (9) Other Gas Supply Expenses (\$2011, excluding labor loading), (10) Certain Distribution Expenses (\$2011, excluding labor loading), (11) Customer Accounts Expenses (\$2011, excluding labor loading), (12) Customer Service and Info Expenses (\$2011, excluding labor loading), (13) Sales Expenses (\$2011, excluding labor loading), (14) Certain Administrative and General Expenses (\$2011, excluding labor loading), (15) Certain Pension and Benefits Expenses (\$2011, before allocation to CA), (16) Regulatory Amortizations, (17) Victor Valley Transmission System (VVTs) Replacement, (18) Depreciation Rates, (19) Depreciation Expense for Southern and Northern California, (20) Certain Taxes, and (21) Results of Examination.

¹¹ Opening Brief filed by Southwest Gas at xiv-xvii.

and General Expenses (\$2011, excluding labor loading and franchise taxes), (9) Certain Pension and Benefits Expenses (\$2011, before allocation to CA), (10) Lead-Lag Study Federal Income Tax (FIT) and California Corporate Franchise Tax (CCFT) Lag Days, (11) Materials and Supplies, (12) Customer Advances, (13) Upstream Pipeline and Storage Costs, (14) Infrastructure, (15) Depreciation and Amortization Expense, (16) Benefits, and (17) Certain Taxes.

Below, we address those issues that are still in dispute.

5.1. Rate Base

Southwest Gas's rate base consists of multiple components, including: (1) net plant; (2) working capital; (3) customer advances; and (4) deferred taxes. In developing its proposed test year 2014 rate base for each jurisdiction, Southwest Gas analyzed and applied generally accepted industry methodologies that are in line with the evidence in the record and prevailing law. Overall, we find that Southwest Gas' requests regarding rate base are justified and reasonable in light of the record.

5.1.1. Net Plant

Southwest Gas and ORA agree that the projected 2012 gross plant and accumulated depreciation amounts in the Company's Southern California and Northern California rate jurisdictions should be updated with the actual recorded amounts experienced in year 2012. We approve of these updates which reflect changes to net plant for 2012 and all years thereafter. Updating these amounts, consistent with parties' agreed amounts, results in a decrease to net plant in Southern California of \$1,955,427 and an increase to net plant in

Northern California of \$1,393,928.¹²

ORA has not similarly agreed nor proposed/recommended updated net plant and accumulated depreciation amounts for the South Lake Tahoe jurisdiction. ORA does acknowledge that: (1) “[d]ue to the cumulative nature of plant additions from year-to-year, it is preferable to eliminate a year of project estimates if more recent recorded data provides an appropriate basis for the plant forecast,” which approach “is generally consistent with [O]RA’s approach in other rate cases”;¹³ and (2) ORA was provided the updated 2012 amounts for South Lake Tahoe and did not object to any of the Southwest Gas’s 2012 actual plant additions. Further, ORA agreed to update gross plant and accumulated depreciation when actual amounts were available in the last three Southwest Gas general rate cases, and in this proceeding, we see no justification for why the South Lake Tahoe gross plant and accumulated depreciation amounts should not be similarly updated, as proposed.

The net plant amount for South Lake Tahoe should therefore be updated, consistent with the approach agreed to by the parties for the Company’s Southern California and Northern California jurisdictions. This update would result in an increase in net plant of \$1,026,370 for tax year 2012 and \$927,088 for tax year 2014.

5.1.2. Working Capital

5.1.2.1. Cash Working Capital

ORA does not contest or otherwise object to any of the Southwest Gas’s

¹² SWG-23 at 3; and SWG-37 at 3. We disregard some inadvertent modeling errors in the record of this proceeding which referenced \$1,183,923, instead of correct figure of \$1, 393,928.

¹³ DRA-06 at 1-4.

proposed cash working capital amounts in the three rate jurisdictions. Although ORA agrees with Southwest Gas's proposed cash working capital amounts, ORA has recommended different tax lead-lag days.¹⁴ ORA's recommended lead-lag days relative to FIT and CCFT are inappropriate as ORA relies on the lag days associated with Southwest Gas's historical tax payments, instead of looking forward and considering the federal and state statutorily mandated tax payment filing dates and percentages.

Indeed, due to some atypical events that occurred during the historical time period referenced by ORA, reliance on these past payments will not result in a lag day estimate that is indicative of the test year's lag days during the years the rates from this proceeding are in effect.¹⁵ Further, ORA's methodology used to determining its proposed tax lead-lag days conflicts with the Commission's ruling in the Company's 2003 test year general rate case decision where the Commission rejected the use of actual income tax lag days where the base year included atypical tax payments, as is the case here.¹⁶

Here, Southwest Gas recommends 37.75 FIT and 21.00 CCFT lag days for all three of its California rate jurisdictions. That is reasonable and appropriate because these lag days are based on the actual federal and state statutorily mandated tax payment filing dates and percentages on a going forward basis. Southwest Gas's proposed quarterly estimated tax payments during 2014

¹⁴ These lead-lag days are generally factored into the calculation of cash working capital (SWG-2 at Ch. 17, Sh. 25; SWG-3 at Ch. 17, Sh. 25; SWG-4 at Ch. 17, Sh. 24), but ORA opted not to do so in this proceeding as ORA accepted Southwest Gas's proposed amounts. (DRA-07 at 2, Table 7-1, at 8, Table 7-7, at 14, Table 7-13.)

¹⁵ SWG-22 at 14, 15.

¹⁶ D.04-04-048 at 5.

through 2018, and the associated proposed lag days, are dependent on meeting these specific statutory deadlines. No evidence has been presented showing any circumstances that are expected to occur during these years to support the utilization of any method other than the one proposed in the Application.

Because the due dates for estimated tax payments do not change as the result of any past paid amounts, the lag days are independent of the historical tax payment amounts. In other words, the process behind the Company's calculation of its proposed lag days (as based upon the measurement of days between the applicable service period midpoint and the date on which an estimated tax payment will be made in order to meet statutory deadlines) occurs regardless of whether the Company is required to make an estimated tax payment. Over the calendar year, there is an approximate 37.75 FIT and 21.00 CCFT day lag between the service period midpoint (in this case July 1, 2011) and the date Southwest Gas files or reports to the taxing agency, which is usually a day or two before the statutory due date.

Consistent with prior Commission decisions, and in consideration of ORA's agreement with Southwest Gas's proposed cash working capital amounts, we find Southwest Gas's proposed methodology for arriving at these lag days reasonable, and we adopt them in this proceeding.

5.1.2.2. Materials and Supplies

Southwest Gas's proposed five-year average materials, and supplies forecast accurately reflect the variability expected to be experienced by the Company when rates from this proceeding are in effect. The record in this proceeding shows the materials and supplies balance includes a certain amount of variability as the result of ongoing changes in inventory levels from year-to-year due to factors such as customer growth and replacement work. As a

result of this natural volatility, it is reasonable to normalize this account to consider historical cost data from both low and high inventory years.

Evidence detailing the Company's materials and supplies balances in each of its three California rate jurisdictions supports a five-year average. Southwest Gas experienced high growth years between 2007 and 2008, which resulted in higher costs relating to materials and supplies during these years. While these costs declined from 2008 to 2010, they have been once again increasing since 2010. As a result of this recent increase in materials and supplies costs, normalization of both high and low cost years is appropriate and reasonably represents estimated costs that the Company can expect to experience going forward. Thus, Southwest Gas's proposed use of a five-year average of past materials and supplies data is reasonable and is approved for all three of its California rate jurisdictions.

ORA's recommended three-year average of past materials and supplies data is unpersuasive. ORA's proposal assumes that the most recent historical data shows a decrease in costs associated with materials and supplies. That is contrary to the recent upward trends in costs associated with materials and supplies, the Company has experienced. For example, in Southwest Gas's Southern California rate jurisdiction, the expenses associated with materials and supplies have steadily increased from approximately \$674,000 in 2010 to \$843,000 in 2011 and \$2,100,000 in 2012. Similar increases have been experienced by Southwest Gas's Northern California and South Lake Tahoe rate jurisdictions.

ORA's proposed three-year average ignores both high growth years between 2007 and 2008 as well as these recent increases experienced and shown by Southwest Gas, in this proceeding. In doing so, ORA's methodology would yield less reliable forecast of what has been a volatile and variable material and

supplies expenses being actually experienced and projected by the Company, for the time when the rates from this proceeding would be in effect. Based on the foregoing, we are not persuaded by ORA's proposal.

5.1.3. Customer Advances

Due to substantial decline in customer growth in the past five years, coupled with the ongoing refund of existing advances to customers and conversion of existing advances to contributions in aid of construction, Southwest Gas projects that its customer advance balances will continue to decrease in the coming years. To project this decreasing trend in customer advance balances, Southwest Gas uses a methodology that factors in all relevant data, including declining trend in the balance amounts, the average monthly decline in these balances, and then applies this same average monthly decline to projected future years. Southwest Gas further demonstrated the reasonableness of its methodology by comparing its projected customer advance balances for 2012 with the updated 2012 actual balances. This comparison shows that Southwest Gas's projected monthly balances were very close to the actual balances in each of its rate jurisdictions.

ORA disagrees with this projection and methodology and instead claims "an upward trend in Customer Advances."¹⁷ ORA then proposes a three-year average of recorded customer advances data for projection. ORA's objection to the Company's proposed methodology and projection seems to be premised upon its assertion that there has been an "upward trend" in account balances, the record in this proceeding of the actual historic trend does not support this contention. ORA also anticipates that before the end of 2014 the

¹⁷ DRA-07 at 5, 11, 16.

customer advances Southwest Gas receives for main extension construction will exceed the advances refunded to customers and advances converted to contributions in aid of construction. Again, the record in this proceeding does not support this proposition.

We find that Southwest Gas has adequately demonstrated the reasonableness of its customer advances projections and the methodology it uses for projecting customer advances, and we adopted it.

5.1.4. Deferred Taxes

ORA recommends three changes to Southwest Gas's proposed deferred taxes, including adjustments: (1) reflecting bonus depreciation; (2) updating 2012 projected plant additions to actual additions and other adjustments to projected net plant additions; and (3) excluding net operating losses (NOLs) from the common deferred tax calculation.¹⁸ We address these changes recommended by ORA, below.

5.1.4.1. Deferred Tax Treatment of Bonus Depreciation and Net Plant Additions

First, ORA proposes to adjust Southwest Gas's deferred taxes to reflect the 2013 bonus depreciation statutory rates set forth in The American Taxpayer Relief Act of 2012. ORA recommends adjustments to the Company's deferred taxes to reflect 2013 bonus depreciation in its Southern and Northern California rate jurisdictions. For its South Lake Tahoe jurisdiction, ORA does not similarly apply 2013 bonus depreciation to the intangible plant included in the Southwest Gas's Systems Allocable Gas Plant.¹⁹

¹⁸ DRA-08 at 2.

¹⁹ Transcript, Vol. 2 at 313, 317.

While Southwest Gas agrees with ORA's recommendation on 2013 bonus depreciation, Southwest Gas objects to ORA's inconsistent application of 2013 bonus depreciation. Southwest Gas argues that consistent application of 2013 bonus depreciation is essential.

We are, in part, persuaded by ORA's recommended adjustments to and calculations of deferred taxes to reflect 2013 bonus depreciation. We further find that there is no justification that it should be applied inconsistently here; thus, we find that consistent application of 2013 bonus depreciation is appropriate. Therefore, we find that adjustments to the Company's deferred taxes be made to reflect 2013 bonus depreciation in all of its three California rate jurisdictions, including its South Lake Tahoe jurisdiction.

Second, ORA proposes to adjust Southwest Gas's deferred taxes to reflect what Southwest Gas refers to as "hypothetical 2014 bonus depreciation."²⁰ ORA makes this recommendation notwithstanding its acknowledgment that: (1) current federal income tax law does not allow bonus depreciation for property placed in service in 2014; (2) it is unaware of any pending legislation that would support the continuation of bonus depreciation beyond 2013; (3) its inclusion of 2014 bonus depreciation is speculative; and (4) application of 2014 bonus depreciation could result in a violation of the normalization rules found in the Internal Revenue Code Section 168.²¹ ORA's own witness admitted the foregoing and that it is inappropriate and contrary to existing tax law to calculate bonus depreciation on assets placed in service in 2014.²²

²⁰ DRA-08 at 8.

²¹ Transcript, Vol. 2 at 259, 260.

²² *Id.*; SWG-22 at 3.

Based on the foregoing, we find no merit in ORA's recommendation that Southwest Gas's deferred taxes be adjusted for ORA's proposed hypothetical 2014 bonus depreciation.

Finally, ORA recommends adjusting the Company's deferred taxes to update 2012 projected plant additions to actual plant additions, as well as other adjustments to the Company's projected net plant additions. As discussed below, we have several concerns with ORA's proposed adjustments and calculations.

At the heart of ORA's proposed adjustments and calculations is ORA's "scalar" factor.²³ One major concern with this "scalar" factor is that it is a brand new and unproven method of adjusting deferred taxes to reflect changes in net plant additions.²⁴ ORA simply made a composite – one size fits all – adjustment by attempting to estimate the total change in deferred taxes for not only net plant additions, but also for 2013 bonus depreciation and hypothetical 2014 bonus depreciation.²⁵ ORA's own witness, who developed the "scalar" factor admits the "scalar" factor has not been accepted or acknowledged by the Internal Revenue Service (IRS).²⁶

²³ Transcript, Vol. 2 at 260, 261, 262.

²⁴ These calculations include applying the appropriate depreciation rates to the net change in the applicable plant addition balances, and then multiplying this adjusted depreciation by the appropriate federal or state tax rate to determine the impact on deferred taxes. SWG-22 at 8, 9, Table 2.

²⁵ DRA-08 at 8; SWG-22 at 4.

²⁶ Transcript, Vol. 2 at 269, 317, 318-320, 322, 323, 324; Transcript, Vol. 3 at 373, 374, 375-382, 383. (ORA's recommendations relating to taxes, including deferred taxes, and "scalar" factor were sponsored by ORA witness with educational background and work experience primarily devoted to issues pertaining to pensions and benefits and limited experience in providing testimony in the subject area of tax expenses. Transcript, Vol. 2 at 253.)

This “scalar” factor was then applied to produce a combined adjustment. Industry practice and method is to perform individual calculation for each adjustment. Here, after recalculating the excess tax depreciation to reflect actual tax depreciation amounts, ORA simply multiplied the resulting additional tax depreciation by its “scalar” factor – as opposed to the appropriate income tax rates – and treated the result of its calculation as the proposed adjustment to deferred tax liability for **both** bonus depreciation and net plant additions, instead of performing separate calculations for each adjustment. In fact, ORA’s witness admits ORA did not use an actual tax rate “... [b]ecause when [he] did apply a tax rate, the numbers did not look reasonable.”²⁷

In addition, ORA’s calculation of deferred taxes by applying its “scalar” factor seems improper for several other reasons, as testified to by Southwest Gas’s witness. For instance, the ratio that ORA used as a “scalar” factor was derived from entirely different bases, thus the resulting relationship has no relevance for any other set of facts as this computation results in a meaningless ratio. Thus, if ORA’s unorthodox and unproven “scalar factor” is applied here, the resulting calculations would have to be flawed as its “scalar” factor ratio stems from comparison of amounts from schedules with data that represent different factors considered for each of the referenced schedules.

In addition, ORA applies its “scalar” factor inconsistently within and across Southwest Gas’s three rate jurisdictions. For example, in the Company’s Southern California and South Lake Tahoe rate jurisdictions, ORA proposed a separate “scalar” factor for 2012, 2013, and 2014, but did not actually apply its 2013 and 2014 “scalar” factors. Instead, ORA used the 2012 “scalar” factor and

²⁷ Transcript, Vol. 2 at 271.

applied it to 2012, 2013, and 2014. For the Company's Northern California rate jurisdiction and its Systems Allocable account, ORA proposed a separate "scalar" factor for each year and then applied the corresponding factor to the corresponding year's information. We find this inconsistency in application of "scalar" factor and the resulting calculations are without reasonable justification.

Likewise, we find ORA's calculation of the base number (in this instance, the annual amount of excess tax depreciation over book depreciation) to which it applied its "scalar" factor were also inconsistent. In some rate jurisdictions, the base number included 2013 and ORA's hypothetical 2014 bonus depreciation, while in other jurisdictions it did not.

Finally and most importantly, we find the results generated by applying ORA's "scalar" factors also are unreasonable and illogical. For instance, in Southwest Gas's South Lake Tahoe rate jurisdiction, ORA's calculations produced a base amount (i.e. excess of book over tax depreciation) of \$2,173,573 for 2014. As acknowledged by ORA, this amount is comparable to taxable income. After substituting its "scalar" factor of 257 percent for the applicable tax rate of 35 percent, ORA applied its purported "tax rate" to the base amount, resulting in a deferred tax amount of \$5,590,969. In other words, the use of ORA's recommended "scalar" factor produces tax rates as high as 257 percent, thereby suggesting that the Company owes more in deferred taxes than it has in taxable income. Such an outcome is unreasonable.

Further, the resulting deferred tax liability amount, using ORA's methodology, is mathematically not possible to achieve given the Company's existing plant in its South Lake Tahoe rate jurisdiction. In the improbable event that the IRS allowed the Company to deduct all of the remaining undepreciated tax basis for all of its existing plant in South Lake Tahoe in one year (2014), the

highest the amount the deferred tax liability could be at the end of 2014 is approximately \$12 million. However, based on its cumulative series of calculations using its “scalar” factor, ORA estimates that at the end of 2014, the total deferred tax liability for South Lake Tahoe should be \$14.8 million. In order to reach this figure, Southwest Gas would have to deduct all of its remaining plant in South Lake Tahoe plus another \$8 million of plant that does not currently exist.

For the reasons set forth above, we conclude that ORA’s development and application of its “scalar” factor produce deferred tax calculations ignore the applicable statutory tax rates and produce numbers that are implausible, unreasonable, and unsupported by the record of this proceeding. Instead, we find Southwest Gas’s proposed deferred tax liability balances, including its calculations of deferred tax liability adjustments for 2013 bonus depreciation and net plant adjustments, reasonable. We therefore adopt Southwest Gas’s deferred tax calculations.

5.1.4.2. Deferred Tax Treatment of Net Operating Losses

There seems to be some confusion as to inclusion of Southwest Gas’s net operating losses (NOLs) in its calculation of deferred taxes. Southwest Gas contends that in its original filing, the Company properly estimated the “stand-alone” impact of the NOLs by applying specific allocation percentages to the total Southwest Gas utility NOLs. Subsequently, in response to ORA’s recommendation, and because ORA did not consistently calculate “stand-alone” NOLs in its deferred tax calculation, the Company recalculated the “stand-alone” NOLs by applying jurisdictional specific income and expense items for each of its California rate jurisdictions, including the System Allocable account.

Now, ORA’s recommendation, which Southwest concurs, is that “the

Commission continue its policy of ‘stand-alone’ tax basis by excluding the losses (and gains) of corporate parents, affiliates, and subsidiaries.” We intend to do so here. Southwest Gas’s has already recalculated the “stand-alone” NOLs by applying jurisdictional specific income and expense items for each of its California rate jurisdictions, including the System Allocable account, and set those recalculations forth in the Prepared Rebuttal Testimony of Company witness Ivan M. Holland, as revised in the Correction to Prepared Rebuttal Testimony of Ivan M. Holland (Southwest Gas’s Recalculations).²⁸

Consistent with the Commission’s “stand-alone tax basis” policy, we find that Southwest Gas’s Recalculations, including the Systems Allocable account, and NOLs should be reflected in the calculation of deferred taxes. In addition, Southwest Gas’s revised deferred tax calculations, as referenced above, are accepted as being accurate, reliable, and reasonable.

5.1.5. Gross Revenue Conversion Factor

Southwest Gas’s proposed Gross Revenue Conversion Factor, the uncollectibles percentages, is reasonable and therefore approved. While ORA’s proposed uncollectibles percentages are slightly lower, the variance and proposed adjustment is nominal and without adequate justification.

5.2. Attrition

5.2.1. Annual Post-Test Year Margin Adjustment

In Southwest Gas’s last California general rate case, D.08-11-048, the Commission approved a settlement between SWG and DRA that provided a 2.95 percent annual attrition amount for Northern and Southern California, along with an annual fixed dollar amount of \$103,000 for SLT, as a post-test year

²⁸ SWG-22 at 9, 10, Table 3; SWG-31 at 10, Table 3.

margin (PTYM) adjustment.²⁹

Going forward, Southwest Gas requests that the previously approved rate of 2.95 percent be extended through the time period in which rates from this proceeding will be in effect. For the test year 2014, Southwest Gas projects an annual revenue deficiency of approximately \$11.5 million in its three California jurisdictions and is seeking rate increases based on these projected deficiencies.

An inadequate attrition percentage would further compound the current deficiency amounts in future years. In turn, that would result in more substantial rate increases in future proceedings.

Moreover, such an outcome would be additionally exacerbated by the impact that the reduction in depreciation rates and lack of future bonus depreciation will have on the Company's capital revenue requirement going forward.³⁰ Because capital revenue requirements are determined almost entirely by the relationship between capital additions and the associated depreciation, presuming capital additions are carried out at the levels forecasted by the Company, the depreciation rates applied to those additions – which will effectively reduce the amount of revenue required to fund the additions – will be diminished, thereby resulting in a greater revenue requirement and an increase in the current deficiency amounts in future years.

Southwest Gas's PTYM argument is based largely on inertia. The Commission approved a settlement figure of 2.95 percent in D.08-11-048. With

²⁹ The Commission also approved a PTYM increase of a fixed \$103,000 per year for the Company's South Lake Tahoe rate jurisdiction. SWG-14 at 10.

³⁰ Based on the depreciation study filed by Southwest Gas in this proceeding, the Company is proposing, and ORA has agreed to (DRA-07 at 6), a decrease in the applicable book depreciation rates. (SWG- 23 at 6.) In addition, and as previously set forth in this decision, bonus depreciation will cease at the end of 2013. See *supra* at Section 5.1.4.1.

rates going into effect January 1, 2009, PTYM adjustments began in 2010, and during the applicable time periods (2010-2011), the Company's actual results were slightly above authorized at some times, and slightly below authorized at others, indicating that the PTYM adjustment was not inappropriate.

ORA recommends a PTYM adjustment that is less than half of the 2.95 percent per year proposed by the Company.

As opposed to being based on a fixed percentage related to the capital expenditure cost increases expected to be incurred by the Company, ORA recommends an annual attrition mechanism based on a variable rate derived from the All Urban-Consumer Price Index (CPI-U), less a 0.5 percent productivity factor designed to spur Southwest Gas to become more efficient, explaining "CPI-U reflects the cost increases experienced by SWG's ratepayers."³¹ At the same time, ORA acknowledges that the principal driver of an attrition mechanism is the projected capital expenditure cost increases incurred by the Company.

We are unpersuaded by ORA's CPI-U argument. There is some precedent for using CPI-U rates and productivity factors in other rate cases such as in D.13-05-010, but it is not binding on the Commission and may not be appropriate in all cases; even in D.13-05-010, the Commission used a heavily modified CPI-U rate, indicating that CPI-U alone fails to capture actual utility costs. Moreover, the Commission has previously recognized that the use of a CPI index does not necessarily support a reasonable level of spending by a utility when it stated that "CPI increases, or inflation increases in general, are not linked to the capital expenditure cost increases that the utility incurs . . . [f]or that reason, a CPI

³¹ DRA-01 at 14.

increase may not fairly represent reasonable overall cost increases to the utility.”³²

ORA has also argued that Southwest Gas should not receive a higher attrition percentage than larger utilities such as Southern California Gas Company, essentially arguing for a 2.75 percent cap for Southwest Gas attrition percentages to bring it in line with Southern California Gas Company and SDG&E.³³ ORA’s argument is inadequately supported, in part because larger utilities may have greater economies of scale and bargaining power than smaller utilities. However, the 2.75 percent attrition percentages offer a valuable baseline for comparison.

We are persuaded by ORA’s productivity factor argument. Without such a factor, a utility would have less incentive to improve the efficiency of operations.

In the present case, Southwest Gas has not sufficiently justified its proposed attrition percentage of 2.95 percent. While 2.95 percent may have been reasonable as part of a settlement and while it may have worked reasonably well, it does not necessarily mean 2.95 percent is reasonable going forward, especially as interest rates and inflation change, and in light of low consumer price index inflation percentages. Furthermore, extending Southwest Gas’s proposed 2.95 percent attrition does not adequately promote productivity increases for the utility to operate more efficiently. We adopt a 0.2 percent productivity factor to compensate.

Altogether, we adopt a PTYM adjustment (annually for years 2015 through

³² D.06-05-016 at 304.

³³ ORA Revised Comments at 10.

2018) of 2.75 percent for each California rate jurisdiction. We find that this level of adjustment would likely mitigate the rate impacts that an increase in the Company's current deficiency amounts will have on its customers going forward. This level would also promote productivity and efficiency increases. Lastly, this attrition percentage would bring Southwest Gas in line with other California gas utilities for similar time periods.

We find that Southwest Gas's proposal to increase the PTYM annually for years 2015 through 2018 by 2.95 percent for each of its California rate jurisdictions is inadequately supported. We find that ORA's proposed attrition percentages are also inadequately supported.

5.2.2. South Lake Tahoe Annual Post-Test Year Margin Adjustment for Accelerated Aldyl-A Replacement

Southwest Gas requests cost recovery associated with its proposal to accelerate the replacement of Aldyl-A (AA) pipe in its South Lake Tahoe jurisdiction. Southwest Gas requests that the expected revenue requirement related to the accelerated AA replacement be recovered through an additional attrition adjustment, specific to South Lake Tahoe, in post-test years 2015 through 2018. Southwest Gas included the cost of replacement that takes place during 2013 and 2014 in the Company's proposed test year 2014 rate base.

ORA opposes this request and argues the Company's proposed program is unnecessary; an associated additional attrition adjustment therefore should be deemed inappropriate. ORA argues that the "embedded investment for Aldyl-A replacements is incorporated in the base margin for the S[outh] L[ake] T[ahoe] District," and that "[O]RA's proposal will provide SWG the necessary funding to

continue replacing Aldyl-A at the current levels.”³⁴ Southwest Gas’s testimony by Kevin M. Lang states, “[it] is not proposing the accelerated replacement of AA due to safety concerns, as Southwest Gas believes the system will continue to operate in a safe and reliable manner that meets or exceeds pipeline safety regulations.”³⁵

We find that Southwest Gas’s request for accelerated Aldyl-A replacement and the additional attrition adjustment is unreasonable and therefore reject it. Southwest Gas has not demonstrated the need to prioritize currently planned Aldyl-A replacement work over other planned safety work by accelerating it. We therefore deny the proposed cost recovery.

5.2.3. Phase-in of South Lake Tahoe Test Year Margin

For the Company’s South Lake Tahoe rate jurisdiction, ORA recommends “that any rate increase in excess of 20 percent be phased in over two years.” Southwest Gas disagrees and argues, *inter alia*, that a phase-in for South Lake Tahoe is inappropriate.

Southwest Gas contends ORA’s reliance on the percent increase as the basis for deciding whether a phase-in is appropriate is somewhat misleading. To illustrate this point, the Company presented a comparison of the present and proposed rates and rate design for analogous schedules in the Company’s South Lake Tahoe and Northern California rate jurisdictions is revealing.

For South Lake Tahoe’s residential rate schedules SLT-10 and SLT-12, the Company’s proposed average rate and rate design results in an increase in

³⁴ DRA-01 at 15, 16.

³⁵ At 14.

margin of \$1,233,779 or 44.4 percent. For Northern California's comparable residential rate schedules GN-10 and GN-12, the Company's proposed average rate and rate design results in an increase in margin of \$1,268,384 or 19.4 percent. The approximate monthly bill impact of these proposals on a primary residential gas service customer using 100 therms during the winter period in South Lake Tahoe is an increase of \$11.76, as compared to an increase of \$14.49 for a similarly situated customer in Northern California – North Lake Tahoe. Based on the comparison of the aforementioned rate schedules, the proposed margin increases are essentially identical for the same number of customers – the only thing that differs is the percent increase. The difference in the percent increase is due to the fact that South Lake Tahoe's rates are lower; therefore, their perceived rate increase appears higher. In reality the margin increase allocated to each customer in these jurisdictions is essentially the same.

At an initial glance, ORA's proposed phase-in proposal seems appealing. However, upon more detailed review of the rate impact, ORA's proposed two-year phase-in proposal for South Lake Tahoe rate increase that exceeds 20 percent is not persuasive and therefore denied.

5.2.4. Victor Valley Transmission System Replacement

As part of the Commission's ongoing rulemaking (R.) docket, R.11-02-019, involving California's natural gas transmission pipeline facilities, Southwest Gas has proposed the replacement of approximately 7.1 miles of transmission pipeline in Victorville, California, commonly referred to as the Company's Victor Valley Transmission System (VVTs). In the instant proceeding, the Company requests that whatever amount is ultimately approved by the Commission in R.11-002-019 docket for VVTs be fully reflected in rates by the year 2015.

On October 21, 2013, the Commission rendered a final decision as to the proposed replacement and found:

Southwest Gas ratepayers should not be required to bear the cost of replacing the pipeline installed in 1965. Accordingly, we find that the costs of replacing 2,175 feet of pipeline should be assigned to shareholders for that portion of the Victor Valley Transmission System.³⁶

D.13-10-024 moots this request by the Company since we did not approve any amount for VVTS. We find Southwest Gas's proposed VVTS recovery proposal moot and therefore deny it.

5.3. Cost of Capital

Southwest Gas proposes a capital structure consisting of 43 percent long-term debt and 57 percent common equity, with a requested return on common equity (ROE) of 10.40 percent. ORA accepts the Company's methodology for calculating the embedded costs of long-term debt. Southwest contends its cost of capital proposal results in overall rates of return that properly reflect its business, financial and regulatory risks, and provides the Company an opportunity to earn a fair and reasonable return on its California distribution properties. ORA instead recommends common equity ratio of 51.7 percent common equity coupled with its recommended 9.58 percent ROE.

Southwest Gas argued that ORA's recommended cost of capital proposals would impede the Company's ability to attract capital on a reasonable basis, and to maintain or improve upon its existing credit ratings. Southwest Gas also contends ORA's recommendations are totally inadequate when compared to the Company's proxy group, and when judged against the benchmarks established

³⁶ D.13-10-024 at 13-14; *see also, id.* at 18.

by the Commission in its prior decisions.

5.3.1. Legal Standards

The United States Supreme Court defined the legal principles to be considered by the Commission in determining a utility's rate of return in the landmark cases of *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*,³⁷ and *Federal Power Commission v. Hope Natural Gas Company*.³⁸ In *Bluefield*, the Court held that rates that are not sufficient to yield a reasonable return on the value of the property used in public service are unjust, unreasonable, and confiscatory.³⁹ The Court further stated that a public utility is entitled to such rates as will permit it to earn a return on the value of the property equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings with corresponding risks and uncertainties, and that:

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate...to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.⁴⁰

The *Hope* decision reinforces the principles established in *Bluefield* decision and provides additional guidance for the Commission to assess the reasonableness of a utility's rate of return, holding that revenues must be sufficient to cover capital costs, and "...the return to the equity owner should be

³⁷ 262 U.S. 679 (1923).

³⁸ 320 U.S. 591 (1944).

³⁹ *Bluefield*, 262 U.S. 679, at 690.

⁴⁰ *Id.* at 693.

commensurate with returns on investments in other enterprises having corresponding risks.”⁴¹

Therefore, Southwest Gas should be authorized to earn a rate of return that is: (1) commensurate with returns on investments in other firms having corresponding risks; (2) sufficient to assure confidence in the Company’s financial integrity; and (3) sufficient to maintain the Company’s creditworthiness and ability to attract capital on reasonable terms.

5.3.2. Capital Structure

Consistent with the principles of future test year ratemaking, the Commission may consider and adopt a capital structure that is consistent with the actual capital structure the Company is expected to achieve during the period that rates from this proceeding are in effect. Southwest Gas operates on a five-year general rate case cycle (test year plus 4 attrition years) meaning that its next general rate case will be filed in 2017 with a 2019 test year. Thus, the capital structure authorized in this proceeding should consider the Company’s projected capital structure during that period.

Here, Southwest Gas’s requested capital structure is generally supported by evidence that: (1) the Company’s capital structure has improved considerably since its last California general rate case; (2) the Company’s proposed 57 percent common equity ratio is consistent with the overall projected common equity ratios for the proxy group; and (3) the Company’s requested capital structure is also generally consistent with its target bond rating. However, as discussed in detail below, we find to be more reasonable to adopt a cost of capital proposal with common equity ratio of 55 percent and 10.10 percent ROE.

⁴¹ *Hope*, 320 U.S. 591, at 603.

In short, common equity ratio of 55 percent is reasonably close to the Company's most current common equity figure of 54 percent and strikes a reasonable balance between those of the California energy utilities' capital structures (common equity ratio of 52 percent), ORA's proposed 51.7 percent, the Company's most current common equity figure of 54 percent and the Company's proposed 57 percent. A common equity ratio of 55 percent is also consistent with and within the Moody's target range.

In addition, based on our review of the similarities between Southern California Gas Company and Southwest Gas as well as our overall balancing of relevant variables and comparison of the Company's proposed ROE to Southern California Gas Company's recently authorized ROE of 10.10 percent, we find that an ROE of 10.10 percent is reasonable here. Although the Company's higher recommendation of 10.40 percent ROE is generally well-reasoned and supported by the financial models and generally consistent with the authorized ROEs for other utilities in California, we find the 10.10 percent ROE is more reasonable here while still being consistent with the Company's financial models, the national average and the Commission-authorized ROEs for other California energy utilities in D.12-12-034. Lastly, the 10.10 percent ROE is reasonably supportive of the Company's improved credit ratings.

5.3.2.1. Improved Capital Structure

Southwest Gas's capital structure was last reviewed in its Test Year 2009 general rate case. At that time, the Commission approved a capital structure consisting of 47 percent common equity, 3 percent preferred stock and 50 percent long-term debt.⁴² Since then, the Company significantly improved its common

⁴² Southwest Gas redeemed all of its preferred securities on March 29, 2010. SWG-15 at 21.

equity ratio, increasing it by 5.9 percentage points, from 47.1 percent to 53 percent. The testimony of the Company's witness also showed that its common equity ratio continues to improve. As of April 30, 2013, the Company's actual common equity ratio was 54 percent.⁴³ Based on the improvements to date, the Company requests a capital structure consisting of 57 percent common equity. The Company anticipates that it will likely achieve its requested equity ratio of 57 percent in the period, from 2014 through 2018.

ORA does not offer any evidence to dispute the Company's evidence of improved capital structure. Likewise, ORA does not offer any evidence to dispute that the Company's actual common equity ratio was 54 percent as recently as April 2013.

ORA recommends a capital structure consisting of 51.7 percent common equity based on the Company's actual capital structure at December 31, 2012. In support of its recommendations, ORA argues that its recommended capital structure is close to or otherwise comparable to the Company's authorized capital structures in Arizona and Nevada and the authorized capital structures for the four major California energy utilities in D.12-12-034.

As for ORA's argument based on the Company's capital structure previously authorized in Arizona and Nevada, we are not persuaded. As for ORA's argument that the Company's authorized capital structures should better align with that of the four major California energy utilities in D.12-12-034, we agree. While there are some differences between Southwest Gas and these major California energy utilities, there are sufficient similarities that we should look to the major California energy utilities as a reference and consider thoughtful

⁴³ SWG-24.

alignment with California's energy utilities, when that is justified and reasonable.

For instance, although Southwest Gas has smaller customer base, it provided undisputed evidence that it has similar credit ratings to the major California energy utilities involved in the cost of capital proceeding. Southwest Gas also presented evidence that it has risk metrics that are comparable to those of Sempra Energy and Pacific Gas and Electric (PG&E) Corporation.

Based on our review, amongst the California's energy utilities, Southern California Gas Company is probably most similar to Southwest Gas. In fact, Southwest Gas acknowledges that it was even included in Southern California Gas Company's proxy group in the cost of capital proceeding.

In short, we generally agree with Southwest Gas's reasoning, but we also agree with ORA that the Company's authorized capital structures should better align with that of the four major California energy utilities in D.12-12-034. As such, we decline to approve the Company's proposed common equity ratio of 57 percent which is disproportionately high compared to the major California energy utilities, most of with the common equity ratio of 52 percent including Southern California Gas Company. Instead, we approve a common equity ratio of 55 percent. This is a common equity ratio that strikes a reasonable balance between those of the California energy utilities' capital structures (common equity ratio of 52 percent), ORA's proposed 51.7 percent, the Company's most current common equity figure of 54 percent and the Company's proposed 57 percent.

5.3.2.2. Proxy Group Comparison

Southwest Gas presented comparison to the proxy group to support its proposed common equity ratio of 57 percent. ORA adopted the same proxy group proposed by the Company in this proceeding. Southwest Gas presented

evidence that in 2012, the average actual common equity ratio for the proxy group companies was 56.9 percent. In addition, the projected average common equity ratio for years 2013-2018 is 56.3 percent. ORA does not dispute this evidence and, in fact, ORA witness testified that based on his calculations, the proxy group's average actual common equity ratio for 2012 was 57.23 percent. If proxy group comparison is the sole factor in determining what would be a reasonable common equity ratio here, then, Southwest Gas's proposed common equity ratio of 57 percent should be approved. However, it is not. It is one of several factors we examine.

Here, we have examined the proxy group comparison, and we find that a common equity ratio of 55 percent is generally within a reasonable range when compared to the proxy group. In addition, as noted earlier, on balance, we find that a common equity ratio of 55 percent should be approved because it is also reasonably close to the Company's most current common equity figure of 54 percent and strikes a balance between the Company's proposed 57 percent with ORA's proposed 51.7 percent as well as the California energy utilities' capital structures (common equity ratio of 52 percent).

5.3.2.3. Relationship to Target Credit Rating

The Commission has held that, "[b]ecause the level of financial risk that the utilities face is determined in part by the proportion of their debt to permanent capital, or leverage, we must ensure that the utilities' adopted equity ratios are sufficient to maintain reasonable credit ratings and to attract capital."⁴⁴ Indeed, evidence shows that recent improvements in Southwest Gas's credit

⁴⁴ D.12-12-034 at 5.

ratings were a function of the sustained improvement in the Company's common equity ratio.

Evidence also shows the Company's long-run goal of attaining an "A" credit rating and the Company's plan to pass on corresponding benefits to its customers. In part, one of the Southwest Gas's witnesses explained that having a common equity ratio that is similar to the proxy group companies and consistent with the target debt to capital ratios provided by the rating agencies is key to achieving an "A" rating. In response, ORA offers no evidence to dispute Southwest Gas's showing that the companies within its proxy group that have "A" ratings have a common equity ratio of approximately 56 percent on a permanent capital structure basis.

Moreover, the evidence demonstrates that Moody's target range for the debt to capital ratio of an "A" rated company is 35-45 percent, which equates to a common equity ratio of between 55 and 65 percent. A common equity ratio of 55 percent we approve today is consistent with and within the Moody's target range.

5.3.3. Return on Equity

Using the *Hope* and *Bluefield* decisions as its guide, the Commission has stated:

We attempt to set the ROE at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation. To accomplish this objective, **we have consistently evaluated analytical financial models as a starting point to arrive at a fair ROE.**

(Emphasis added).⁴⁵

As such, we know developing an appropriate ROE involves more than just a mathematical exercise. It requires judgment that, "...has to be made by reference to observable parameters, one of which, of course, [is] authorized returns in other jurisdictions...and in fact sometimes the subject jurisdiction."⁴⁶

Here, Southwest Gas's proposed ROE of 10.40 which was based on more comprehensive ROE analysis and reasoning. In contrast, ORA's recommendations are not based on ROE analysis or examination beyond taking the simple average of the results of four financial models, resulting in a recommended ROE of 9.58 percent. This ROE is disproportionately lower than the ROEs authorized for the major California energy utilities, which range from 10.10 percent to 10.40 percent. Moreover, ORA's proposed ROE falls well short of the national average ROE for natural gas utilities.

On balance, we decline to approve the Company's proposed ROE of 10.40 percent. Instead, we approve an ROE of 10.10 percent, consistent with the ROEs we recently authorized for the major California energy utilities, which range from 10.10 percent to 10.40 percent.

We looked to the major California energy utility that most resembles Southwest Gas as a guide here. We determined earlier in this decision that Southern California Gas Company was most similar to Southwest Gas, amongst the four major California energy utilities.

Based on our review of the similarities between Southern California Gas Company and Southwest Gas as well as our overall balancing of relevant

⁴⁵ *Id.* at 18.

⁴⁶ Transcript, Vol. 2 at 185.

variables and comparison of the Company's proposed ROE to Southern California Gas Company's recently authorized ROE of 10.10 percent, we find that an ROE of 10.10 percent is reasonable here. Therefore, we adopt an ROE of 10.10 percent.

5.3.3.1. Financial Models

Both Southwest Gas and ORA utilized the Constant Growth (or Single-Stage) Discount Cash Flow (DCF), Multi-Stage DCF, Historic Risk Premium and Capital Asset Pricing Model (CAPM) models as part of their ROE analysis. In most areas, Southwest Gas and ORA generally agree. However, ORA's analysis is flawed in two key respects. First, ORA's analysis does not include the Sustainable Growth⁴⁷ estimate in its Constant Growth DCF analysis and cited certain drawbacks to the Sustainable Growth estimate. Southwest Gas presented evidence that it was generally reasonable to include the Sustainable Growth estimate in the analysis for this proceeding. Moreover, evidence show that had the Sustainable Growth estimate been used in ORA's calculations, ORA's Constant Growth DCF model results would have been higher and would in fact be very similar to that of Southwest Gas.

Second, ORA's CAPM model includes a measure of historical market risk premium (MRP). MRP is "... the difference between the expected return on the market in general, and the risk-free rate of return (measured by the yield on long-term Treasury securities)."⁴⁸ ORA calculated two forward-looking measures of MRP and one historical measure, and used the average of those

⁴⁷ The Sustainable Growth Rate fundamentally reflects the company's expected Return on Common Equity and the extent to which those earnings are retained rather than paid out in dividends. SWG-25 at 14.

⁴⁸ SWG-25 at 16.

calculations in his CAPM model. ORA's historical estimate of MRP includes data from 1950 through 2011 and results in an MRP of 6.40 percent for the period 2007-2011.

Because the data used to calculate the historical MRP includes the significant market losses experienced in 2008, the resulting MRP is grossly misstated. ORA's CAPM analysis should have calculated each MRP estimate independently. Instead, it took the average. The results demonstrate that ORA's CAPM results utilizing a historical MRP are wholly unreasonable. Indeed, the resulting ROE (8.11 percent) is 70 basis points below the lowest authorized return in any jurisdiction since at least 1980 and approximately 200 to 230 basis points below the recently authorized returns for California's major energy utilities. Evidence in this proceeding shows ORA's updated and further recalculated MRP estimates and the resulting ROEs are (10.13 percent and 10.66 percent).

We note, these updated and further recalculated MRP estimates and the resulting ROE figures support and are consistent with the ROE of 10.10 percent we adopt here.

5.3.3.2. Comparison of ROE to Other Benchmarks

Perhaps the most significant shortcoming in ORA's ROE analysis is that it is admittedly based solely on the results derived from its application of the financial models. ORA did not take any additional and necessary step of assessing the reasonableness of its ROE result by comparing it to relevant benchmarks. Indeed, when examining ORA's recommended ROE in the context of other authorized ROEs, both within California and on a broader scale, we find ORA's recommendation lacking.

In recent cost of capital proceeding, the Commission authorized ROEs for

the major California energy utilities that ranged from 10.10 percent to 10.40 percent.⁴⁹ This is not unusual given that California is perceived by credit rating agencies as a credit supportive jurisdiction. Evidence also shows both Moody's and Fitch expect California-authorized ROEs to remain above the national average. However, ORA's recommended ROE that is disproportionate when compared to those authorized in D.12-12-034.⁵⁰

As a multi-jurisdictional utility, Southwest Gas does not participate in the Commission's cost of capital proceeding. However, Southwest Gas has acknowledged that it has similar credit ratings to the major California energy utilities involved in the cost of capital proceeding, with a smaller customer base and that its risk metrics are comparable to those of Sempra Energy and PG&E Corporation. Indeed, Southwest Gas was even included in Southern California Gas Company's proxy group in the cost of capital proceeding. Accordingly, it is unreasonable to expect that Southwest Gas's ROE would, as ORA suggests, differ so significantly from the ROEs authorized for the other California utilities by as much as 60-90 basis points.

Moreover, ORA's witness noted that the average ROE for gas distribution utilities in 2012 was 9.94 percent,⁵¹ which is notably higher than ORA's proposed ROE.

Lastly, the potential impact of ORA's ROE recommendation on Southwest Gas's credit ratings, which ORA does not contest, is to reverse the stride that Southwest Gas has made in recent years in improving its credit ratings from

⁴⁹ See generally, D.12-12-034.

⁵⁰ Transcript, Vol. 2 at 201, 202.

⁵¹ *Id.* at 203.

Standard & Poor (S&P), Moody's and Fitch to their current levels of A-, Baa1, and A, respectively. It is therefore important that the Company maintain these credit ratings in order to avoid potentially higher capital costs associated with lower ratings. A return that substantially deviates from recent experience and is well below other relevant measures of the Company's ROE, as Dr. Renaghan has recommended, could affect investors' perceptions of regulatory and financial risk, and increase Southwest Gas's capital costs.

Based on the foregoing, we find that ORA's recommended ROE fails to comply with the Commission's directive that financial models be used as a "starting point" for the ROE determination. Moreover, the evidence shows that ORA's underlying analysis was flawed and that the authorized ROEs for other California utilities and the national average both exceed ORA's recommendation. We find ORA's recommended ROE unreasonable and flawed in its underlying analysis. We therefore reject it.

The record here supports the adoption of 10.10 percent ROE. We note the Company's higher recommendation of 10.40 percent ROE is generally well-reasoned and supported by the financial models and consistent with the authorized ROEs for other utilities in California. However, we find the 10.10 percent ROE is more reasonable here while still being consistent with the Company's financial models, the national average and the Commission-authorized ROEs for other California energy utilities in D.12-12-034. We also find that the 10.10 percent ROE is reasonably supportive of the Company's improved credit ratings. Therefore, we adopt the ROE of 10.10 percent here.

5.3.3.3. Overall Rate of Return and Required Return on Equity

ORA's proposed overall rates of return (ROR) amount to 6.32 percent for

Southern California and 7.77 percent for Northern California and South Lake Tahoe. They are considerably lower than the overall rates of return of 7.32 percent for Southern California and 8.61 percent for Northern California and South Lake Tahoe that result from the Company's filed position.

As mentioned above, Southwest Gas's primary concern with ORA's capital structure and ROE recommendations is that the resulting overall rates of return will negatively impact the Company's ability to maintain or improve its credit ratings and to attract capital at a reasonable cost.

Recent upgrades to Southwest Gas's credit ratings indicate that the rating agencies recognize the Company's improving financial profile. Regulatory support is an important factor in maintaining Southwest Gas's current ratings, and ultimately achieving its target "A" bond rating. In light of the fact that rating agencies perceive California as credit supportive, and that they expect California-authorized ROEs, and resulting RORs, to remain above the national average, the Commission's adoption of an ROE as low as that recommended by ORA in this proceeding, could create uncertainty in the minds of credit rating agencies and investors as to whether sustained regulatory support will be forthcoming in the future. In turn, such an outcome could lead to lower credit ratings and higher future capital costs paid by customers.

Similarly, because Southwest Gas must compete with other utilities and other investment opportunities to attract capital, the Company must demonstrate the ability to achieve a competitive risk-adjusted return on that capital.

ORA's proposed ROE can be checked for reasonableness related to capital attraction using three benchmarks, as explained by Southwest Gas's witness. The first two benchmarks compare the recommended ROE to the average authorized ROE for natural gas distribution companies, and to the average

authorized ROEs for California's major energy utilities. As we discussed above, the evidence shows that ORA's recommendation is considerably lower than both the national average and the Commission-authorized ROEs in D.12-12-034. The third benchmark judges ORA's recommended ROE against the historical and prospective returns on the book value common equity of other natural gas distribution companies. Upon analyzing the historical (2008-2012) and prospective (2013, 2014, 2016-2018) returns for the Company's eight proxy group members, evidence shows the average historical ROE for the proxy group is 11.33 percent and the average prospective ROE for the proxy group is 11.16 percent.

Because Southwest Gas has a higher investment risk than the average investment risk associated with the proxy companies, an authorized ROE that is significantly less than that expected for the proxy group, could send a negative signal to the financial community and put Southwest Gas at a competitive disadvantage in terms of attracting capital.

In sum, we reject ORA's recommendation here. We find that ORA fails to provide a complete and appropriate cost of capital analysis and. As such, we find that its cost of capital recommendations are unreasonable, particularly in relation to Southwest Gas's improved financial profile and its ability to attract future capital. Instead, as discussed in the foregoing sections of this decision, we find that a common equity ratio of 55 percent and 10.10 percent ROE are reasonable and supported by evidence in this proceeding. We therefore adopt Southwest Gas's cost of capital proposal with common equity ratio of 55 percent and 10.10 percent ROE.

5.4. Operating Expenses

In utility ratemaking, the establishment of just and reasonable rates

requires the consideration of three factors: (1) the utility's operating expenses; (2) the utility's rate base; and (3) a reasonable rate of return.⁵² Accordingly, the rates set by the Commission should allow the utility to recover its costs of providing service (both capital and operating), plus a reasonable return on the value of its property devoted to public use.⁵³ As such, the authorized recoverable amount of a utility's operating expenses has a direct effect upon the calculation of rates.

As discussed in detail below, here, we find that Southwest Gas has made sufficient evidentiary showing to substantiate the reasonableness and prudence of its operating expenses. We are therefore not persuaded by ORA's opposition to said expenses.

5.4.1. Operations and Maintenance Expenses

Operations and maintenance expenses include the following: (1) gas supply and distribution expenses; (2) customer accounts expenses; (3) customer service and information expenses; and (4) sales expenses. ORA did not propose any adjustments to Southwest Gas's proposed test year labor and materials and expenses for gas supply expenses or customer service and information expenses, and these expenses are accepted as filed. In addition, Southwest Gas is not requesting recovery of sales expenses in this general rate case, thus an adjustment was made in each of the Company's California rate jurisdictions to

⁵² See e.g., *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz. 588, 20 P.3d 1169, 1172 (2001)(citing *Scates v. Arizona Corporation Commission*, 118 Ariz. 531, 578 P.2d 612 (1978)); *Public Utility Commission of Texas v. Houston Lighting & Power Company*, 748 S.W.2d 439 (Tex. 1988).

⁵³ *City and County of San Francisco v. P.U.C.*, 6 Cal.3d 119, 129 (1971). See also, *Southern California Edison Co. v. P.U.C.*, 20 Cal.3d 813, 818 (1978)(utility rates are essentially the sum of operating expenses and return on invested capital).

remove these expenses. As a result, the only remaining disputed operations and maintenance expenses addressed below are those associated with distribution expenses and customer account expenses.

5.4.1.1. Distribution Expenses

When projecting distribution costs, it is appropriate to consider the distribution function as a whole since each individual account within the distribution function can vary widely from year to year based on work requirements. With this in mind, Southwest Gas consistently bases its initial projection for distribution expenses, with the exception of rent expense, on a five-year average.

As reflected in ORA's report, ORA accepts Southwest Gas's forecasted test year distribution expense estimates for several accounts. However, for the remaining accounts, ORA deviates from Southwest Gas's consistent application of the proposed five-year average and instead considered the Company's 2012 recorded distribution expenses. ORA then adjusts these expenses in selected accounts where the 2012 number was lower than Southwest Gas's projection.

ORA's explanation for its use of 2012 recorded numbers and not the five-year average for select accounts was that "[u]se of a multi-year average will tend to capture variances, but may not closely reflect the latest expense experience."⁵⁴ ORA's explanation is troublesome in several ways.

First, if ORA is concerned with "reflecting the latest expense experience," then it should apply the 2012 actual numbers to all distribution accounts, rather than just selecting certain accounts where the 2012 number is coincidentally lower than Southwest Gas's projection.

⁵⁴ DRA-04 at 4.

Second, the latest experience in an account does not in and of itself represent an accurate reflection of normal ongoing level of expense, which is what the test year projection should be indicative of. Rather than focusing solely on distribution accounts with decreases, attention should instead be given to the distribution function as a whole since each individual account within the distribution function can vary widely from year to year based on work requirements.

Third, ORA's analyses as to what circumstances warrant the use of the "latest expense experience" are inconsistent. In some instances, ORA takes the position that a lack of volatility in distribution expenses from year to year supports the use of 2012 actual numbers instead of a historical average. However, when considering other accounts ORA reasons that the application of 2012 actual numbers is more appropriate than a historical average due to a "considerable variance" in distribution expenses from year to year.

ORA's use of an inconsistent approach in determining when and when not to use 2012 distribution expense amounts yields inexplicable and inconsistent results. Instead, on this point, we find that Southwest Gas's reasoning and consistent application of a historical average to project distribution expenses (with the exception of rents expense for the reason previously stated) as its methodology are sound. Therefore, we approve Southwest Gas's proposed methodology of basing its projection for distribution expenses, with the exception of rent expense, on a five-year average.

5.4.1.2. Customer Accounts Expenses

Southwest Gas's projected customer accounts expenses are based on recorded 2011 expenses, subject to certain adjustments. Similar to the distribution expenses, ORA accepted Southwest Gas's forecasted test year

customer accounts expense estimates for several accounts.

Notwithstanding ORA's acceptance of adjusted recorded 2011 expenses for estimating most accounts, ORA inexplicably applies data from other years – primarily 2012 actual amounts – to forecast the remaining accounts. For instance, when considering Federal Energy Regulatory Commission (FERC) Account 903 (Customer Records & Collections), ORA accepts Southwest Gas's projected expenses for its Southern California rate jurisdiction. However, for the Company's Northern California and South Lake Tahoe jurisdictions, which are also based on adjusted recorded 2011 expenses, ORA objects to the Company's forecast and instead recommends using 2012 recorded expenses, claiming that they "are more recent and appropriate."

Notably, the 2012 recorded expenses in the Company's Northern California and South Lake Tahoe jurisdictions were lower than the adjusted 2011 expenses, while the 2012 recorded expenses were higher than the adjusted 2011 expenses in the Company's Southern California jurisdiction. ORA's selective focus on years with lower expense amounts is not justified or supported by reasoning.

In addition, the adjusted 2011 expense forecast that ORA accepts for Southern California includes an adjustment for the Company's Call Center and Support Function, which benefits all California customers. Yet, ORA's recommendation for Northern California and South Lake Tahoe expenses, as based on 2012 recorded amounts, again and inexplicably does **not** include a similar adjustment for the Call Center and Support Function. ORA acknowledges that this inconsistent adjustment was improper. When asked whether Northern California and South Lake Tahoe customers should pay a share of the Call Center and Support Function, ORA witness responded with a

“yes.” Notwithstanding this admission, the 2012 recorded numbers which ORA relies upon to project Account 903 for Northern California and South Lake Tahoe do not include such an adjustment.

We are not persuaded by ORA’s recommendations and its unexplained and inconsistent approaches, and we find ORA’s recommendation to update this account to 2012 recorded amounts in these jurisdictions unconvincing. Here, we find that Southwest Gas’s forecasts for Account 903 in Northern California and South Lake Tahoe are reasonable and consistent with the methodology used to project Account 903 in Southern California.

The other remaining contested account relating to customer accounts expenses is FERC Account 904 (Uncollectibles). The core of the disagreement with respect to the expenses forecasted for this account relates to parties’ projected uncollectible rates. While Southwest Gas consistently derives its projected test year uncollectible rates from the applicable 2011 uncollectible rates, ORA once again takes an inconsistent approach in arriving at its recommendations.

For the Company’s Southern California rate jurisdiction, ORA departs from its recurring argument favoring the more recent the data, as the better data, and instead recommends the use of information dating back to 2007 to forecast the test year uncollectibles rate for this jurisdiction.

However, a review of the historical data for the uncollectibles rate shows a fairly significant variance in the rate from the years 2010-2012 to the year 2007. Although there has been a gradual decrease in the uncollectible rate between 2010 and 2012, the significant decrease being recommended by ORA is unsupported by the evidence in this proceeding.

Notwithstanding its recommendation to use 2007 data to develop the projected uncollectibles percentage for Southern California, ORA recommends using 2012 recorded uncollectibles expense for Northern California and South Lake Tahoe. ORA's inconsistent and unexplained recommendations for these jurisdictions for uncollectible rates from different historical years among its rate jurisdictions is not persuasive. If the 2012 recorded uncollectibles percentage is going to be applied for Northern California and South Lake Tahoe, at a minimum, that same rate should be consistently applied for Southern California.

We therefore find ORA's recommendation unpersuasive. Instead, we find Southwest Gas's methodology of consistently deriving its projected test year uncollectible rates from the applicable 2011 uncollectible rates reasonable here.

5.4.2. Administrative and General Expenses

The disputed Administrative and General expenses in this proceeding relate to: (1) Injuries and Damages expenses in Southern California and Northern California (Account 925); and (2) System Allocable Office and Supplies expenses (Account 921). As discussed below, for FERC Account 925 we find that Southwest Gas's forecasted expenses are based on sound methodology, and derive reasonable results. We also find ORA's forecast methodologies lack consistency and applicability and reject them. For FERC Account 921, we find that Southwest Gas's forecasted expenses are not adequately supported and find in favor of a five-year average.

5.4.2.1. Injuries and Damages

Account 925 contains expenses related to legal fees, injuries and damages, and workers' compensation. A certain portion of the expenses within Account 925 relates to the Company's self-insured retention and is not disputed by ORA. Southwest Gas does point out that ORA has misstated the self-insured

retention amount in Southern California by approximately \$25,145. With respect to the remainder of the Southern California Account 925 balance, parties differ.

Given the nature of the expenses included in this account, it is reasonable to expect that account balances will fluctuate from year to year, depending on the number of claims, the amount of legal fees incurred, etc. Even ORA's witness agrees that these types of expenses can vary from year to year. Indeed, Southwest Gas's recorded data for Southern California's Account 925 from 2007-2012 shows that the account balances varied significantly, ranging from a low of \$115,883 to a high of \$682,155. Therefore, Southwest Gas argues that it is reasonable to forecast future account balances using a five-year average. By normalizing the expenses (as opposed to simply picking the recorded account balance from a single year), the Company is able to smooth out the fluctuation over the course of several years, resulting in a more accurate forecast of the expenses that will be incurred when rates from this proceeding are in effect. We agree. In fact, ORA too agrees with this approach with respect to the Company's South Lake Tahoe jurisdiction. However, ORA again and inexplicably bases its Southern California Account 925 forecast on the Company's recorded data for 2011.

The Company's Northern California jurisdiction experienced fluctuation in its Account 925 balances in the same manner as Southern California. Southwest Gas once again utilizes a five-year average to develop its forecast. ORA again and inexplicably selects a single year of recorded data for its forecast and elects to use the 2012 recorded data for its Northern California estimate, rather than data from the same year it considered in Southern California (2011).

ORA's recommended forecast methodologies lack consistency and applicability and we therefore reject them.

5.4.2.2. Office and Supplies

Account 921, System Allocable Office and Supplies, has seen a modest rise from \$11.2 million (2007) to \$13.8 million (2012), in 2011 dollars. Not every year has seen a rise, but the trend is generally upwards. However, 2007 was an anomalously low year at \$11.2 million, the next lowest year being 2008 at \$12.9 million and significantly lower than the \$13.8 million in 2012 recorded expenses. Southwest Gas explained that their telecommunications and call center costs rose after 2007. Southwest Gas projects that the increased level of costs in Account 921 will be sustained over time. As a result, Southwest Gas projects the Account 921 balances using recorded 2011 expenses, which is the highest in the 2007-2012 timeframe. The 2011 balance (\$13,790,687) reflects ongoing expenses that the Company anticipates incurring during the period that rates from this proceeding are in effect.

In contrast, ORA utilized a five-year average (2007-2011) to account for variability in the Account 921 balance. We find that neither approach is satisfactory. Southwest Gas's reliance on a single data point is inadequate to support their projection. ORA's five-year average is more methodologically sound, but includes an outlier (2007). We find that a five-year average of 2008-2012 FERC Account 921 balances is appropriate in this case and results in an average figure of \$13,266,834 which we will adopt in lieu of Southwest Gas's proposed \$13,790,687 forecast.

5.4.3. Pensions and Benefits

The disputed issues involving pensions and benefits include: (1) projected amounts for various pension and benefits expenses; (2) ORA's proposed removal of 100 percent of flex benefits expenses; (3) ORA's proposed removal of 100 percent of certain executive benefits; (4) labor loadings; and (5) ORA's

proposed adoption of a one-way balancing account for pension expenses. The record here shows that Southwest Gas's proposals are well-reasoned, accurate and supported by the evidence. ORA's position on each of these issues are unpersuasive due to miscalculations, misinterpretations, and/or selective and unsupported reasoning that is inconsistent with Southwest Gas's business operations and the Commission's prior findings.

5.4.3.1. Pension and Benefits Accounts

Parties disagree on the projected balances in a number of pension and benefits expenses – namely, Life and Accidental Death and Disbursement (AD&D) Insurance, Medical Insurance, Employee Assistance Plan (EAP), Employee Investment Plan (EIP), Tuition Reimbursement, Long Term Disability (LTD), Employee Communications, and Miscellaneous Benefits. The primary dispute as to each expense relates to one critical misstatement and one significant miscalculation on the part of ORA.

First, as explained by Company witness, the Company's projections were based on adjusted 2011 amounts in 2011 dollars. Those projections correspond with the 2011 amounts found at SWG-02, Chapter 18, Sheet 3, Column B. ORA's witness testified that she intended to evaluate the Company's proposed expenses based on 2011 dollars and, to that end, her written testimony includes various tables (Tables 5-29, 5-31, 5-33, 5-39, 5-41, 5-43, 5-45 and 5-49), all of which indicate in the title that they are based on 2011 dollars. However, evidence later showed that the actual dollar amounts inserted into those foregoing ORA tables on the lines labeled "SWG" represent 2014 dollars. ORA therefore misstates the Company's proposal as to each of these expenses. Second, and despite ORA's stated intention with respect to the use of 2011 dollars, ORA's own calculations for a majority of these expenses consist of nominal dollars rather than 2011

dollars. As a result of both errors, ORA fails to present an appropriate and reliable expense amounts that we can coherently compare to the expense amounts proposed by the Company.

To aid in our deliberation, Southwest Gas reconstructed the relevant ORA tables such that Southwest Gas's proposal was accurately stated in 2011 dollars and ORA's corresponding recommendation was calculated in 2011 dollars. With respect to Medical Insurance, EAP, EIP, Tuition Reimbursement, LTD and Employee Communications, making these simple corrections results in ORA, presumably updated/corrected, recommendations (Updated Tables) that are more closely aligned with those of the Company, and which the Company accepts. With respect to the Life and AD&D, the Company continues to request adoption of its proposed amount, as ORA's recommendation for this account appears to also be incorrectly based on 2012 recorded data. With respect to Miscellaneous Benefits, the Company continues to object to ORA's recommendation, but offers an alternative calculation that removes a benefit that is no longer offered by Southwest Gas and, as a result, lowers the Company's recommended amount.

ORA did not object, nor did ORA offer any evidence to refute the calculations reflected in the Updated Tables. Further, ORA offers no evidence to dispute the Company's position on the Life and AD&D and the Miscellaneous Benefits expenses. Based on these facts, we find Southwest Gas's positions, calculations and recommendations as to each of the Pension and Benefits expenses discussed herein reasonable and adopt them.

5.4.3.2. Flex Benefits

ORA recommends excluding 100 percent of the costs associated with Southwest Gas's Flex Benefits account because ORA contends Southwest Gas

already uses ratepayer monies to reimburse employees for, "...certain eligible health care expenses such as acupuncture, Christian Science practitioners, cosmetic surgery, guide dog, air conditioning when necessary to relieve allergies or breathing difficulties, smoking cessation programs and elastic hosiery for medical purposes."

However, when the Company's flexible benefits plan was introduced into evidence and reviewed with the ORA witness, the witness conceded that the list of health care expenses denoted in her written testimony are not actually reimbursed using ratepayer monies, and are in fact reimbursed with monies that employees contribute through automatic deductions to their paychecks.

Southwest Gas's own witness also testified confirming that other expenses included in the flex benefits account, such as the administrative fees on the Company's medical and dental benefits, executive physicals, and employee "life credits" actually form the basis for the Company's projection.

We find the Company's request to recover these costs reasonable.

5.4.3.3. Executive Benefits

ORA also recommends adjustments that would exclude 100 percent of the Company's costs related to the Supplemental Executive Retirement Plan (SERP) and the Executive Deferred Compensation Plan (EDCP) from cost of service. In both instances, ORA's recommendations appear to reflect certain misunderstanding of the plan, combined with misinterpretation and misapplication of the decisions from this and other commissions. Southwest Gas requests including 100 percent of costs related to SERP and EDCP in cost of service. As discussed below, we find that it is reasonable and appropriate for ratepayers and shareholders to equally share in these costs.

SERP: Because the IRS limits the amount of compensation that can be

considered for benefits under the Company's basic retirement plan, officers also participate in the Company's SERP. The SERP is a non-qualified plan.

In opposing the Company's requested cost recovery, ORA contends that pension contributions funded by ratepayers through the Company's traditional retirement plan offer "sufficient compensation" for executives, and that the SERP benefit is merely a means to "enhance and increase retirement benefits for executives."

Due to the limitations imposed under the Employee Retirement Income Security Act of 1974 (ERISA) and the Pension Protection Act of 2006 (PPA), the retirement benefit for highly compensated employees, as a percentage of salary, is less than the maximum benefit available to other employees. Therefore, the primary benefit of the SERP is to offer executives retirement benefits at the level, on a percentage of salary basis, that other employees receive from the basic retirement plan.⁵⁵

ORA also argues that its recommended denial of SERP costs is consistent with ORA's policy in other California cases. However, Commission's findings regarding SERP benefits differ from both Southwest Gas' and the ORA's policy preferences. In fact, in the recent Southern California Gas Company's and San Diego Gas & Electric Company's general rate case decision, the Commission concluded:⁵⁶

[S]uch plans are offered to entice [executives] to work at the two companies for a prolonged period of time. These plans also provide ratepayers with the benefit of having a continuity of executives and managers who are familiar with

⁵⁵ SWG-10R at 7.

⁵⁶ D.13-05-010 at 887.

the corporate culture and the policies and objectives of the companies. For those reasons, it is reasonable and appropriate for ratepayers and shareholders to equally share in these costs.

In short, we find that a 50/50 allocation between ratepayers and shareholders reasonable and consistent with our prior decisions.

EDCP: The EDCP is a non-qualified plan, available to a select group of key Company employees, which affords the opportunity to defer up to 100 percent of their annual cash compensation. ORA recommends 100 percent disallowance of the Company's EDCP costs because ORA believes that Southwest Gas matches an additional 3 percent for executives participating in the EDCP, over and above the Company match that is provided under the Company's Employee Investment Plan (the qualified plan offered to all Company employees). This is an erroneous belief.

ORA's objection is based entirely on this single mistaken belief. Based on that mistake, ORA reasons that the cost recovery should be disallowed to prevent Southwest Gas from allowing its executives to "double-dip" by awarding a match for both the EDCP and the EIP.

The evidence actually shows that Southwest Gas's executives only receive a Company match through the EDCP. This ensures that the executives do not receive any benefits related to the Company match in excess of what employees receive through the EIP.

Moreover, evidence also shows the EDCP is common practice in the utility industry, and provides Southwest Gas with tools to recruit and retain qualified executives. As the Commission stated in the SEMPRA GRC, quoted above, such plans provide a benefit to both ratepayers and shareholders, thus the costs

should be shared equally⁵⁷.

Based on the foregoing, we find that a 50/50 allocation between ratepayers and shareholders is reasonable.

Southwest Gas's Overall Compensation: The unopposed testimony and executive compensation study provided by Southwest Gas Establish that the SERP and EDCP are essential components of Southwest Gas 's overall compensation package that not only provided important tools for the Company to competitively attract and retain qualified executives, but to maintain a level of parity in benefits. ORA offers no objection to the remainder of Southwest's Gas's overall compensation. Under the circumstances, Southwest Gas explains, denying recovery for certain pieces of the overall compensation would produce an illogical and inequitable result, as follows:⁵⁸

There seem to be no arguments in the direct testimonies of the [O]RA about the overall level of compensation, and the market study presented in my direct testimony defines a reasonably competitive compensation package for the executive group, including showing that the executives at Southwest Gas are consistently paid at a level at or below the competitive median level as defined by the market. Including in rates a reasonable competitive compensation package for this group should not be viewed as unjust or unreasonable. However, the removal of these components from rates would certainly be unjust and unreasonable to Southwest Gas, and cause misalignment with what I believe to be proper comparison data. The testimony reviewed offers no alternatives to any of Southwest Gas's current compensation packages – other than a proposal to exclude from rates. This makes it difficult to understand what might be considered a “fair” compensation package by the [O]RA.

⁵⁷ *Id.*

⁵⁸ SWG-19 at 5, 6.

Disallowance of 100 percent of the SERP and 100 percent of the EDCP would place the Southwest Gas executives' compensation at the bottom of the market....

Based on the foregoing, we find that Southwest Gas's request for 100 percent recovery of its SERP and EDCP expenses is reasonable and supported by the evidence, and we approve this request.

5.4.3.4. Labor Loadings

Parties disagree on the appropriate labor loading calculation. Due to the errors referenced above, in Section 5.4.3.1, ORA's labor loading calculation is wrongly calculated using escalated 2014 dollars rather than 2011 dollars. It is also based on ORA's miscalculated benefits recommendations, which use nominal dollars instead of 2011 dollars. In addition, by basing its labor loading calculation on the labor and the pension and benefits recorded on Southwest Gas's books during 2011, ORA incorrectly includes payroll taxes in the calculation, and it includes pension amounts based on an accrual, rather than a cash basis.

Here, Southwest Gas's testimony establishes that the correct calculation of labor loading rates is based on 2011 dollars, includes pension amounts on a cash basis, and excludes payroll taxes. As such, the appropriate labor loading rate should be calculated using these parameters upon the Commission's final decision concerning the various expenses referenced herein.

5.4.3.5. Balancing Account for Pension Expense

ORA agrees with Southwest Gas's recommended pension expense included in the Company's cost of service. However, ORA requests the Commission to establish a one-way balancing account for the Company's pension expenses. The basis ORA provides for its proposal is that, "[g]iven the

ongoing recovery of the U.S. economy, ORA expects that the value of pension investments will rise substantially in the short-term. To protect ratepayers, SWG should establish a one-way balancing account.”

Southwest Gas’s witness testified that neither Southwest Gas ratepayers nor Southwest Gas shareholders have required balancing account protection for pension costs in the past. Southwest Gas also argued that its customers have substantially benefitted over the past 10 years, as the Company’s actual pension costs have exceeded previously authorized amounts and shareholders were required to contribute to the difference. Therefore, Southwest Gas explains that it would be inequitable to require shareholders now to assume the risk of future declines in pension costs, after they have assumed the risk of increasing costs for the past ten years. Even ORA’s witness testimony suggests that ORA’s proposed one-way balancing account is unreasonable since she testified that she has no knowledge of any other California utility that has a one-way balancing account for pension cash basis.⁵⁹

As a result, ORA’s proposed one-way balancing account is unjustified here. However, it would be equally inequitable to require ratepayers to assume the risk of future increases in pension costs. Therefore the appropriate course for this proceeding is to implement a two-way balancing account. Neither ratepayers nor shareholders will bear the risk of fluctuating pension costs.

5.4.4. Depreciation and Amortization Expense

ORA stated that it did “not take issue with the TY 2014 depreciation rates proposed by SWG.” The depreciation rates contained in the Southwest Gas’s filed depreciation study is reasonable and we adopt it.

⁵⁹ SWG-20 at 91, 92.

While Southwest Gas agrees with ORA's application of these rates in deriving the applicable depreciation expense relative to the direct division and System Allocable accounts for its Southern California and Northern California rate jurisdictions and the System Allocable account for South Lake Tahoe, Southwest Gas again objects to ORA's inconsistent application of these rates in deriving the South Lake Tahoe direct division depreciation expense.

As discussed above, ORA did not consistently update South Lake Tahoe with 2012 actual gross plant amounts, despite updating the other jurisdictions. Just as the updated plant activity for 2012 results should be applied consistently to all three rate jurisdictions, so should the updated accumulated depreciation amounts. The consistent and appropriate application of depreciation expense to South Lake Tahoe results in an increase of the depreciation expense to \$1,132,227, which reflects the increase of \$33,464.

5.4.5. Taxes (excluding Deferred Taxes)

As set forth in ORA's report, ORA accepted the Company's filed rates, calculations, and methodologies relative to the following: (1) federal income tax rate (with the exception of adjustments relating to deferred taxes, as previously addressed herein); (2) payroll taxes (with the exception of the appropriate payroll expenses level to be considered); and (3) franchise taxes (excluding revenues).⁶⁰ In addition, with regard to property taxes, although there was a difference in the Company's originally filed methodology and ORA's report, after considering ORA's recommendation, Southwest Gas accepts ORA's proposed methodology to base these taxes on the estimated assessed values.

With the parties reaching agreement on the treatment of the

⁶⁰ DRA-8 at 3, 4, 8.

aforementioned taxes, the only remaining disputed tax issue relates to the calculation of the CCFT tax rate. While Southwest Gas agrees that the effective tax rate should be used in computing the CCFT for ratemaking purposes, Southwest Gas takes objection to ORA's calculation of this rate.

Notwithstanding his testimony that interest expense is deductible for California tax and ratemaking purposes, ORA witness derived his calculation of the effective CCFT tax rate for each Southwest Gas rate jurisdiction **without** first deducting the applicable interest expense from taxable income **before** dividing this amount into the applicable state income tax expense to arrive at the effective tax rate.⁶¹ This seeming oversight results in an inaccurate effective tax rate.

In this case, Southwest Gas provided a correct calculation of the effective tax rate in the Prepared Rebuttal Testimony of Company witness Ivan M. Holland, and this calculation should be applied where appropriate.⁶²

5.5. Infrastructure

An important part of providing safe and reliable service involves developing and working with regulators to prioritize pipeline infrastructure proposals that respond both to industry concerns and customer needs. In recent years, industry concerns at both the state and federal level have resulted in a heightened focus on safety and ratepayers deserve a methodical replacement of aging and high-risk infrastructure.

Southwest Gas's Application includes three infrastructure-related proposals: (1) the IRRAM; (2) the COYL program; and (3) the accelerated replacement of AA pipe in South Lake Tahoe.

⁶¹ DRA-08 at 3; SWG-22 at 13; Transcript, Vol. 2 at 324, 325, 326.

⁶² SWG-22 at 13; Transcript, Vol. 2 at 324, 325, 326.

ORA opposes all three proposals in their entirety. As discussed below, we find the Company's proposals are arbitrary and the benefits are uncertain at this time compared to other possible safety measures. They have the potential to bear an unreasonable burden on all Southwest Gas ratepayers in order to defray costs that a subset of customers are legally responsible for. Yet, the Commission takes the safety of infrastructure very seriously and the COYL proposal merits further data collection and review. We therefore deny the AA pipe proposal and modify the IRRAM and COYL proposals as described below.

5.5.1. IRRAM

Southwest Gas's proposed IRRAM is an alternative cost-recovery mechanism. The IRRAM focuses on capital investments that are non-revenue producing in nature. Non-revenue producing investments do not generate increased load; examples include certain gas infrastructure, transmission and distribution pipeline replacements, costs associated with unfunded government mandates and other non-revenue producing projects approved by the Commission between general rate cases.⁶³

Southwest Gas claims that mechanisms like IRRAM provide the following benefits:⁶⁴

- Eliminate impediments to investing in non-revenue producing infrastructure by providing for timely cost recovery between rate cases;
- Mitigate customer bill impact by providing annual surcharge adjustments;
- Allow regulatory oversight over utility initiatives to

⁶³ SWG-08 at 7.

⁶⁴ *Id.* at ES 1-2.

- replace infrastructure; and
- Complement the rate case process by applying the same cost-of-service ratemaking principles while avoiding the need for more frequent rate case proceedings.

ORA opposes the IRRAM because, “Southwest has failed to identify any future requirements imposed at the federal or state levels, Southwest’s proposal for an initial IRRAM projected budget...are [sic] inadequately supported.”⁶⁵ We agree with ORA’s position that the COYL proposal and the associated IRRAM projected budget are not supported. However, based on comments from Southwest Gas, we do find a limited COYL program for leak detection surveys for schools a reasonable investment by ratepayers and approve the IRRAM for this revised COYL program only, which amounts to \$8,648.

5.5.2. Customer-Owned Yard Line (COYL) Program

Southwest Gas’s proposed COYL program seeks to help customers manage the underground piping that extends from the outlet of the Southwest Gas meter to the house, building or other structure where gas is consumed. As part of this program, Southwest Gas would leak survey all known COYLs in its California service territories and, if a COYL is found to be leaking, Southwest Gas will offer to relocate the customer’s gas meter and replace the COYL with facilities owned and maintained by Southwest Gas. The proposed COYL program addresses two categories of COYLs – school COYLs and non-school COYLs. COYLs are not utility-owned facilities. According to Southwest Gas’ Tariff Rule Nos. 16 and 19, Southwest Gas has no obligation to inspect or maintain facilities beyond the point of delivery, including COYLs which are

⁶⁵ DRA-11 at 29.

owned, operated and maintained by the customer. The owner of a leaking COYL has three options currently available: (1) relocate the gas meter and replace the COYL with Southwest Gas facilities at the owner's own expense; (2) hire a licensed plumber to repair or replace the COYL; or (3) discontinue gas service. In most cases, customers elect to have a plumber repair or replace the COYL, which remedies the leak. Southwest Gas is concerned that customers may be unwilling or unable to maintain these lines in the safe manner required and relies upon a 2012 report by Commission staff.

The Risk Assessment Unit (RAU) of the Commission's Safety Enforcement Division (SED)⁶⁶ issued a "Database Project Report on Status and Initial Recommendations" (RAU Report) in March 2012, citing 17 potential hazards that impact public safety. The main purpose of the recommendations was for inclusion of new or expanded safety-related issues in the CPUC's Rulemaking on gas safety (R.11-02-019). The RAU Report expressed the following concern with customer-owned piping:⁶⁷

Neither PHMSA nor the CPUC has jurisdiction on most customer-owned or operated service lines. Most of these lines are small gas piping systems. Examples include motels, shopping centers, university campuses, and industrial complexes. Despite the requirement in Part 192.16 (Customer Notification) that the gas operator must inform customers that the customer/owner is responsible for maintaining these systems, it remains a safety concern as the customers/owners are not required to comply with federal or state gas safety regulations.

⁶⁶ Formally known as the Consumer Protection and Safety Division, or CPSD.

⁶⁷ <http://www.cpuc.ca.gov/NR/rdonlyres/381B6603-37A4-48C0-A1B7-D4A56928F6CC/0/RiskAssessmentMarch2012ReportFINAL.pdf>

ORA testifies that it also met with CPSD and “was informed that the RAU recommendations were not official directives from the Commission ordering Southwest to undertake activities that go beyond what is required by current federal regulations and their own Tariff Rules 16 and 19.”⁶⁸ ORA argues that “the COYLs program would unfairly burden Southwest’s customer base with overall additional costs that are associated with those limited customers with COYLs.”⁶⁹

We deny Southwest’s original COYL proposal for the following reasons. The COYL program is not legally required by state and federal laws. Southwest Gas has not demonstrated why the COYL program should be prioritized above a number of other safety recommendations and potential additional measures. A broad change in Commission policy regarding utility responsibility for equipment beyond the utility point of delivery is more appropriate in a rulemaking like R.11-02-019, where costs, benefits, and risks can be fully compared to other safety measure recommendations. In addition, there is inadequate data collected on how many hazardous leaks are found on COYLs on an annual basis. When hazardous leaks are found, Southwest Gas, like other gas operators, currently has the ability to make the situation safe by discontinuing gas service until the facility owner makes the necessary repairs. At that point, the COYL can generally be considered safe without Southwest Gas having to make repairs to the COYL at ratepayers’ expense. Southwest Gas provided cost estimates in the case that 1% or 5% of customers surveyed need repairs, but these are illustrative only and not based on any evidence.

⁶⁸ DRA-11 at 32.

⁶⁹ Id.

The Commission takes safety precautions on either side of the meter seriously. We therefore authorize Southwest Gas to conduct leak surveys for 259 private and public schools included in Southwest Gas' application at a cost of \$8,648⁷⁰. "CPSD specifically indicated that out of all COYLs, school COYLs were their highest safety concern..."⁷¹ We suggest that Southwest Gas review options available to it for making its leak detection services available to its non-school customers with COYLs, and its repair services to all of its COYL customers, in each case charging individual customers the actual costs for that service. Southern California Gas Company makes such a service available in its list of Non-tariffed Products and Services, under the category of Installation, Maintenance, and Service of Gas Facilities.⁷²

In addition, in D.14-03-021, the Commission approved a three-year pilot program to incentivize voluntary conversions from master-metered natural gas and electricity to direct utility service in mobile home parks and manufactured housing communities. Southwest Gas is subject to that decision and nothing in this decision affects D.14-03-021.

In sum, the evidence shows that the COYL program as proposed is unreasonable and should be modified. The Commission finds it reasonable to authorize leak detection surveys for schools in order to ascertain the actual safety risk.

⁷⁰ SWG-9

⁷¹ *ibid*

⁷² Southern California Gas Company Advice Letter 2669 filed on September 14, 1998 and approved on March 27, 2013, Attachment C.

5.5.3. Accelerated AA Replacement

Southwest Gas's third infrastructure proposal relates to the accelerated replacement of Aldyl-A (AA) pipe in its South Lake Tahoe jurisdiction. AA is one of two pipe types in Southwest Gas's California service areas that the Company considers Early Vintage Plastic Pipe (EVPP). In 2007, Southwest Gas implemented a Company-wide EVPP replacement plan, which focuses on replacing plastic pipe installed from the late 1950s through the early 1980s, and has an anticipated completion date of 2026. In December 2011, the Pipeline Hazardous Materials Safety Administration (PHMSA) transmitted a letter to the Chairman of the National Association of Regulatory Utility Commissioners (NARUC), recommending that state public utility commissions consider accelerating work on certain types of high-risk infrastructure.⁷³ Plastic pipe manufactured in the 1960s to early 1980s is included on PHMSA's list for recommended high-risk infrastructure warranting accelerated work. The March 2012 RAU report also cites AA pipe as the first of its 17 potential hazards.⁷⁴ AA pipe of a certain vintage, or the environment in which it is installed, can be more prone to failure which can be induced by point loads such as rocks or tree roots.

As of August 2012, Southwest Gas had approximately 93,500 feet of known AA services and approximately 209,000 feet of AA mains in its South Lake Tahoe jurisdiction. Southwest Gas proposes an additional attrition adjustment that would allow the Company to accelerate the replacement of AA pipe in South Lake Tahoe such that all such pipe will be replaced by 2018, rather than

⁷³ SWG-18 at Exhibit 1.

⁷⁴ SWG-32.

2026. Southwest Gas contends that the accelerated replacement of AA will enhance the overall integrity and reliability of its system.

ORA's opposes the accelerated AA replacement proposal and testifies that "[t]he Company has admitted the accelerated replacement of Aldyl-A is not for safety reasons, and SLT's ratepayers already face a substantial rate increase."⁷⁵ Southwest's Lang testified that "Southwest Gas is not proposing the accelerated replacement of AA due to safety concerns."⁷⁶

Southwest has not provided any evidence to justify the accelerated replacement.

Based on the foregoing, we deny the Company's proposal to accelerate the replacement of AA pipe in South Lake Tahoe and deny the associated cost recovery. AA pipe replacement should not be taken out of context from an overall safety plan. The methodical replacement of AA pipe continues to be important to the Commission. The Company should continue its Company-wide EVPP replacement plan.

5.6. Rate Design

ORA agrees with the Company's billing determinants and Class Cost of Service Study, and accepts the Company's rate design methodology, as set forth in the Prepared Direct Testimony of Company witness Frank J. Maglietti, Jr. and Chapter 20 of the Company's Application. ORA also accepts the Company's proposals to establish a new rate schedule for special contract customer LUZ, and to make changes to the distribution shrinkage rate charged to transportation volumes. Said proposals are detailed in Mr. Maglietti's testimony. The rate

⁷⁵ DRA-01 at 15.

⁷⁶ Lang at 14

design portion of the Company's Application also includes proposals for two new rate mechanisms and changes to the Company's upstream pipeline and storage charge calculations.

5.6.1. New Rate Mechanisms

As discussed above, Southwest Gas's Application includes a proposal to establish a cost recovery mechanism, the IRRAM, for infrastructure replacement and other non-revenue producing infrastructure projects. Consistent with that proposal, the Company seeks to establish a surcharge to collect the first year IRRAM budget of \$232,665 in Southern California, \$48,345 in Northern California, and \$58,942 in South Lake Tahoe.

ORA opposes the IRRAM and the proposed COYL program that forms the basis for the first year surcharge; however, ORA offers no objection to the surcharge calculation methodology.

Here, we approve the IRRAM and all or part of the corresponding first year budget and also authorize the Company to establish the appropriate customer surcharge.

The Company also seeks approval of its California Conservation and Energy Efficiency (CEE) Plan, as discussed more fully below. ORA agrees with the Company's proposed CEE program portfolio as well as the related CEE surcharge, which will be used to recover program costs.

We approve the CEE Plan, as discussed below, and also authorize the Company to establish appropriate customer surcharge.

5.6.2. Upstream Pipeline and Storage Costs

Southwest Gas requests authority to change the calculation of its upstream pipeline and storage costs. Currently, these rates are calculated using cold year and peak season throughput. The Company proposes changing to an average

rate calculation in order to simplify the calculation and enhance customer understanding.

ORA's opposes this request. ORA's opposition lacks merit. ORA argues that the proposed change is "unsupported" because Southwest Gas did not provide a forecast of changes to pipeline and storage costs for 2014 through 2018. Evidence however shows Southwest Gas did in fact support its proposal with a schedule demonstrating the *de minimus* difference in rates calculated using the new methodology versus the existing one and that the reason why the schedule does not include a forecast is because the Company does not anticipate that pipeline and storage costs will change significantly in the next rate case cycle.

Based thereon, we find the Company's proposal reasonable and supported by the record. Accordingly, the Company's proposed change is approved.

5.7. Miscellaneous/Other Issues

5.7.1. California Conservation and Energy Efficiency Plan

Southwest Gas requests approval of its California Conservation and Energy Efficiency (CEE) Plan, which consists of CEE programs designed to provide and encourage opportunities for residential and commercial customers to experience reduced energy consumption and lower utility bills. The CEE Plan will result in cost-effective energy savings and advance market transformation, thereby reducing the need for future market interventions. Southwest Gas proposes a \$5 million budget for the CEE Plan (\$1 million per year for 5 years), which will be recovered through the CEE surcharge described above.

ORA agrees with the Company's CEE Plan and the related budget and cost recovery. We find that the Company's request for approval of its California CEE Plan, including related budget and cost recovery, reasonable and supported by evidence, and we approve it.

5.7.2. Automatic Trigger Mechanism

In D.08-11-048, the Commission authorized a PTYM. The PTYM included an Automatic Trigger Mechanism (ATM) which provides for an adjustment to the Company's authorized cost of capital should preset changes occur. Here, Southwest Gas seeks to continue its PTYM for annual changes to rates and charges for gas service, effective January 1, 2015, and each January 1 thereafter through 2018.

Parties agree that Southwest Gas should be permitted to continue the ATM, and that the Company should implement certain modifications to the mechanism. As outlined in the Company's witness testimony, the modifications include:⁷⁷

- The benchmark rate and the measurement period for the ATM will be based on a twelve-month period, rather than the current six-month period;
- The initial ATM benchmark will be established using the average for the twelve month period ended September 30, 2013 for the Moody's Baa Utility Bond Index. The ATM benchmark will remain in effect unless the ATM is triggered and a new benchmark rate is established. The Company will utilize the Moody's Baa Utility Bond index as the reference rate for the ATM, regardless of changes to its bond ratings, until the next general rate case or cost of capital proceeding; and
- The specified criterion established for an off-ramp provision will be removed. Southwest Gas would have the right to file a cost of capital application outside of the ATM upon an extraordinary or catastrophic event that materially impacts its cost of capital and/or capital structure.

⁷⁷ SWG-15 at 30; SWG-24 at 18.

5.7.3. Submetered Discount

Southwest Gas and The Western Manufactured Housing Communities Association agree as to the Company's submetered space discount for each jurisdiction as follows:⁷⁸

- Southern California - \$7.69
- Northern California - \$11.01
- South Lake Tahoe - \$7.69

5.7.4. Results of Operations (RO) Model

Parties agree that the RO Model utilized in this proceeding should be updated to reflect all dollars, allocation methods, and other factors and percentages resulting from the Commission's final order. Southwest Gas is willing to assist ORA and the Commission with the model update.

6. Conclusion

The record in this proceeding supports Southwest Gas's request for approval of a test year 2014 rate increase, post-test year attrition adjustments, recovery of its forecasted operating expenses, a capital structure reflecting a 55 percent common equity ratio, and an ROE of 10.10 percent.

For the foregoing reasons, we find that the rates and charges adopted in this decision are just and reasonable and are supported by the evidence in the record; and that new rates should take effect upon effective date of this decision.

7. Comments on Alternate Proposed Decision

The alternate proposed decision of the President Peevey was mailed on April 24, 2014 to the parties in accordance with Public Utilities Code

⁷⁸ SWG-17 at 8, corrected from as-filed for model errors. The amounts shown above do not reflect the residential basic service charge.

Section 311(d) and Rule 14.3 of the Commission's Rules of Practice and Procedure (Rules). Comments were filed on May 14, 2014, and reply comments were filed on May 19, 2014 by Southwest Gas.

In their respective comments, ORA and Southwest Gas largely reiterated points they have already made.

Additionally, ORA expressed support for the adoption of a 2.75% post-test year margin adjustment (attrition rate), denying Southwest Gas's proposed COYL program, and denying Southwest Gas's proposed acceleration of Aldyl-A pipe in the South Lake Tahoe jurisdiction and associated cost recovery.

Southwest Gas clarified that its proposed COYL program would not take over existing lines but rather relocate the meter closer to the gas-using structure, and thus the facilities extending from the street to the meter would then be owned, operated, and maintained by Southwest Gas.

Southwest Gas's reply comments reiterated its positions on ROE and capital structure and also objected to ORA's failure to provide proposed findings of fact and conclusions of law consistent with its positions, as required by Rule 14.3(c) of the Commission's Rules of Practice and Procedure.

This revised alternate proposed decision is based, in part, on the comments and reply comments received. Specifically, this revision authorizes Southwest Gas to conduct a limited COYL program for leak detection surveys for the 259 proposed schools only and approves \$8,648 for the associated IRRAM.

8. Assignment of Proceeding

Catherine J.K. Sandoval is the assigned Commissioner and Kimberly H. Kim is the assigned ALJ in this proceeding.

Findings of Fact

1. On December 20, 2012, the Company filed the general rate case Application (A.) 12-12-024, seeking authority to increase rates and charges for gas service in California, effective January 1, 2014.
2. The Company is a multi-jurisdictional public utility, providing natural gas service to customers in California, Arizona and Nevada.
3. The Company engages in the retail distribution, transportation and sale of natural gas for domestic, commercial, agricultural and industrial uses and currently serves approximately 1.8 million customers in the states of California, Arizona and Nevada. In California, the Company serves approximately 185,000 customers in three ratemaking jurisdictions: Southern California; Northern California; and South Lake Tahoe. Its Southern California rate jurisdiction comprises various communities and areas in San Bernardino County. Its Northern California rate jurisdiction covers communities and areas in Placer, El Dorado and Nevada Counties, and its South Lake Tahoe rate jurisdiction is entirely within El Dorado County.
4. The Application was filed and supported by justifications, points and authorities, testimony and schedules, claiming that its annual revenue deficiency for Test Year 2014 results in an increase of approximately \$5.6 million for the Southern California rate jurisdiction, an increase of approximately \$3.2 million for the Northern California rate jurisdiction, and an increase of approximately \$2.8 million for the South Lake Tahoe rate jurisdiction.
5. The Company requests, effective January 1, 2014, revenue increases as necessary to recover those costs. In the Application, the Company also seeks approval of its proposed PTYM, an IRRAM and a CEE Plan.
6. In the Company's Test Year 2009 general rate case (D.08-11-048, rendered

in A.07-12-022), the Commission approved an all-party settlement which authorized revenue requirement increases in the Company's Southern California and South Lake Tahoe jurisdictions, and a revenue requirement decrease in the Company's Northern California jurisdiction. The settlement also provided for post-test year revenue requirement increases in all three jurisdictions for the years 2010, 2011, 2012 and 2013.

7. Evidentiary hearings were held in this instant proceeding.

8. Under Section 454(a), a utility shall not change or alter any rate absent a finding by the Commission that the new rate is justified.

9. The burden of proof in ratemaking proceedings rests with the applicant.

10. The evidentiary standard applicable to this burden is preponderance of the evidence.

11. The issues considered here pertain to the establishment of just and reasonable rates that provide the Company a realistic opportunity to earn a reasonable rate of return, while ensuring safe and reliable natural gas service to its California customers.

12. The Company has shown that its annual revenue deficiency for Test Year 2014 results in an increase of approximately \$5.6 million for the Southern California rate jurisdiction, an increase of approximately \$3.2 million for the Northern California rate jurisdiction, and an increase of approximately \$2.8 million for the South Lake Tahoe rate jurisdiction.

13. Based on, inter alia, the opening brief, filed on September 19, 2013, by the Company, which set forth a summary of uncontested issues jointly prepared by the Company and ORA, we find that ORA either supports, agrees with or otherwise do not objects many components of this Application

14. Based on, inter alia, the opening brief, filed on September 19, 2013, by the Company, which set forth a summary of outstanding contested issues jointly prepared by the Company and ORA, we find that ORA either opposes, disagrees with or otherwise objects to number of issues raised by the Applications, as follows: (a) Proposed Revenues and Annual Revenue Deficiency, (b) Rate Base, (c) Gross Revenue Conversion Factor, (d) PTYA, (e) Cost of Capital, (f) Certain Distribution Expenses (\$2011, excluding labor loading), (g) Certain Customer Accounts Expenses (\$2011, excluding labor loading), (h) Certain Administrative and General Expenses (\$2011, excluding labor loading and franchise taxes), (i) Certain Pension and Benefits Expenses (\$2011, before allocation to CA), (j) Lead-Lag Study FIT and CCFT Lag Days, (k) Materials and Supplies, (l) Customer Advances, (m) Upstream Pipeline and Storage Costs, (n) Infrastructure, (o) Depreciation and Amortization Expense, (p) Benefits, and (q) Certain Taxes.

15. The Company's rate base consists of multiple components, including: (a) net plant; (b) working capital; (c) customer advances; and (d) deferred taxes.

16. The Company and ORA agree that the projected 2012 gross plant and accumulated depreciation amounts in the Company's Southern California and Northern California rate jurisdictions should be updated with the actual recorded amounts experienced in year 2012.

17. Updating these amounts, consistent with parties' agreed amounts, results in a decrease in net plant for Southern California of \$1,955,427 and an increase in net plant for Northern California of \$1,393,928.

18. There is no justification for why the South Lake Tahoe gross plant and accumulated depreciation amounts should be treated differently than those of the Company's Southern and Northern California jurisdictions.

19. The net plant amount for South Lake Tahoe, once updated, results in an increase in net plant of \$1,026,370 for tax year 2012 and \$927,088 for tax year 2014 in the South Lake Tahoe jurisdiction.

20. ORA's recommended lead-lag days relative to FIT and CCFT are inappropriate as ORA relies on the lag days associated with the Company's historical tax payments, instead of looking forward and considering the federal and state statutorily mandated tax payment filing dates and percentages.

21. The record in this proceeding shows the materials and supplies balance includes a certain amount of variability as the result of ongoing changes in inventory levels from year-to-year due to factors such as customer growth and replacement work.

22. Due to substantial decline in customer growth in the past five years, coupled with the ongoing refund of existing advances to customers and conversion of existing advances to contributions in aid of construction, the Company projects that its customer advance balances will continue to decrease in the coming years.

23. To project the trend in its customer advance balances, the Company uses a methodology that factor in all relevant data, including declining trend in the balance amounts, the average monthly decline in these balances, and then applies this same average monthly decline to projected future years.

24. ORA recommends adjustments to the Company's deferred taxes to reflect 2013 bonus depreciation in its Southern and Northern California rate jurisdictions, but ORA does not similarly apply 2013 bonus depreciation to the intangible plant included in the Southwest Gas's Systems Allocable Gas Plant.

25. ORA's recommendation to adjust the Company's deferred taxes to update 2012 projected plant additions to actual plant additions, as well as other

adjustments to the Company's projected net plant additions is largely based on ORA's "scalar" factor.

26. ORA's "scalar" factor is a brand new and unproven method of adjusting deferred taxes to reflect changes in net plant additions, which also has not been accepted or acknowledged by the IRS.

27. RA applies its "scalar" factor inconsistently within and across Southwest Gas's three rate jurisdictions.

28. ORA's calculation of the base number (in this instance, the annual amount of excess tax depreciation over book depreciation) to which it applied its "scalar" factor were also inconsistent.

29. ORA's development and application of its "scalar" factor produce deferred tax calculations that ignores the applicable statutory tax rates and produce numbers that are implausible, unreasonable, unsupported by the record of this proceeding.

30. In the Company's last California general rate case, the Commission approved a PTYM adjustment that increased margin annually by 2.95 percent for its Southern and Northern California rate jurisdictions.

31. With rates going into effect January 1, 2009, PTYM adjustments began in 2010, and during the applicable time periods (2010-2011), the Company's actual results were slightly above authorized at some times, and slightly below authorized at others, we find that the PTYM adjustment was appropriate and worked as expected.

32. The Company requests cost recovery associated with its proposal to accelerate the replacement of AA pipe in its South Lake Tahoe jurisdiction and requests that the expected revenue requirement related to the accelerated AA

replacement be recovered through an additional attrition adjustment, specific to South Lake Tahoe, in post-test years 2015 through 2018.

33. The Company included the cost of replacement that takes place during 2013 and 2014 in the Company's proposed test year 2014 rate base.

34. The Company requests that whatever amount is ultimately approved by the Commission in R.11-002-019 docket for VVTS be fully reflected in rates by the year 2015.

34. On October 21, 2013, the Commission rendered a final decision as to the proposed replacement and found:

Southwest Gas ratepayers should not be required to bear the cost of replacing the pipeline installed in 1965. Accordingly, we find that the costs of replacing 2,175 feet of pipeline should be assigned to shareholders for that portion of the Victor Valley Transmission System.⁷⁹

35. The Company proposes a capital structure consisting of 43 percent long-term debt and 57 percent common equity, with a requested return on common equity of 10.40 percent.

36. ORA accepts the Company's methodology for calculating the embedded costs of long-term debt.

37. The Company operates on a five-year general rate case cycle (test year plus 4 attrition years) meaning that its next general rate case will be filed in 2017 with a 2019 test year.

38. The Company's recommendation of 10.40 percent ROE is generally supported by the financial models and generally consistent with the authorized ROEs for other utilities in California.

⁷⁹ D.13-10-024 at 13-14; *see also, id.* at 18.

39. In utility ratemaking, the establishment of just and reasonable rates requires the consideration of three factors: a) the utility's operating expenses; (b) the utility's rate base; and (c) a reasonable rate of return. Accordingly, the rates set by the Commission should allow the utility to recover its costs of providing service (both capital and operating), plus a reasonable return on the value of its property devoted to public use.

40. The authorized recoverable amount of a utility's operating expenses has a direct effect upon the calculation of rates.

41. Operations and maintenance expenses include the following:
(a) gas supply and distribution expenses; (b) customer accounts expenses;
(c) customer service and information expenses; and (d) sales expenses.

42. ORA did not propose any adjustments to the Company's proposed test year labor and materials and expenses for gas supply expenses or customer service and information expenses, and these expenses have been accepted as filed.

43. The Company does not request recovery of sales expenses in this general rate case, thus an adjustment has been made in each of the Company's California rate jurisdictions to remove these expenses.

44. When projecting distribution costs, it is appropriate to consider the distribution function as a whole since each individual account within the distribution function can vary widely from year to year based on work requirements.

45. The Company consistently bases its initial projection for distribution expenses, with the exception of rent expense, on a five-year average.

46. The Company's projected customer accounts expenses are based on recorded 2011 expenses, subject to certain adjustments, and the Company

consistently derives its projected test year uncollectible rates from the applicable 2011 uncollectible rates.

47. The disputed Administrative and General expenses in this proceeding relate to: (a) Injuries and Damages expenses in Southern California and Northern California (Account 925); and (b) System Allocable Office and Supplies expenses (Account 921).

48. The disputed issues involving pensions and benefits include: (a) projected amounts for various pension and benefits expenses; (b) ORA's proposed removal of 100 percent of flex benefits expenses; (c) ORA's proposed removal of 100 percent of certain executive benefits; (d) labor loadings; and (e) ORA's proposed adoption of a balancing account for pension expenses.

49. ORA has not sufficiently justified its proposed balancing account.

50. ORA stated that it did "not take issue with the TY 2014 depreciation rates proposed by SWG."

51. The Company agrees with ORA's application of these rates in deriving the applicable depreciation expense relative to the direct division and System Allocable accounts for its Southern California and Northern California rate jurisdictions and the System Allocable account for South Lake Tahoe.

52. The consistent and appropriate application of depreciation expense to South Lake Tahoe results in an increase of the depreciation expense to \$1,132,227, which reflects the increase of \$33,464.

53. As set forth in ORA's report, ORA accepted the Company's filed rates, calculations, and methodologies relative to the following: (a) federal income tax rate (with the exception of adjustments relating to deferred taxes, as previously addressed herein); (b) payroll taxes (with the exception of the appropriate

payroll expenses level to be considered); and (c) franchise taxes (excluding revenues).

54. With regard to property taxes, although there was a difference in the Company's originally filed methodology and ORA's report, after considering ORA's recommendation, the Company accepts ORA's proposed methodology to base these taxes on the estimated assessed values.

55. With parties reaching agreement on the treatment of the aforementioned taxes, the only remaining disputed tax issue relates to the calculation of the CCFT tax rate.

56. The Company takes pipeline safety seriously while providing safe and reliable service to its customers. An important part of providing that safe and reliable service involves developing and working with regulators to implement pipeline infrastructure proposals that respond both to industry concerns and customer needs.

57. The Application includes three infrastructure-related proposals: (a) the IRRAM; (b) the COYL program; and (c) the accelerated replacement of AA pipe in South Lake Tahoe; and ORA opposes all of the Company's three infrastructure-related proposals.

58. The Company seeks approval of IRRAM, and consistent with its IRRAM proposal, the Company also seeks to establish a surcharge to collect the first year IRRAM budget of \$232,665 in Southern California, \$48,345 in Northern California, and \$58,942 in South Lake Tahoe.

59. IRRAM is a cost-recovery mechanism and focuses on capital investments that are non-revenue producing in nature.

60. Non-revenue producing investments do not generate increased load; examples include certain transmission and distribution pipeline replacements,

costs associated with unfunded government mandates and other non-revenue producing projects approved by the Commission between general rate cases.

61. As part of the proposed COYL program, the Company would leak survey all known COYLs in its California service territories and, if a COYL is found to be leaking, the Company will offer to relocate the customer's gas meter and replace the COYL with facilities owned and maintained by the Company.

62. The Company's proposed COYL program addresses two categories of COYLs – school COYLs and non-school COYLs. COYLs are not utility-owned facilities. The Company is concerned as to whether customers are willing and able to maintain these lines in the safe manner required.

63. The owner of a leaking COYL has three options currently available: (1) relocate the gas meter and replace the COYL with Southwest Gas facilities at the owner's own expense; (2) hire a licensed plumber to repair or replace the COYL; or (3) discontinue gas service. In most cases, customers elect to have a plumber repair or replace the COYL, which remedies the leak.

64. The RAU of the Commission's SED issued a "Database Project Report on Status and Initial Recommendations" (RAU Report) in March 2012, citing 17 potential hazards that impact public safety. The purpose of the recommendations was for inclusion of new or expanded safety-related issues in the CPUC's Rulemaking on gas safety (R.11-02-019). The RAU Report expressed the following concern with customer-owned piping:

Neither PHMSA nor the CPUC has jurisdiction on most customer-owned or operated service lines. Most of these lines are small gas piping systems. Examples include motels, shopping centers, university campuses, and industrial complexes. Despite the requirement in Part 192.16 (Customer Notification) that the gas operator must inform customers that the customer/owner is responsible for maintaining these systems, it remains a safety concern as the

customers;/ owners are not required to comply with federal or state gas safety regulations.

65. There is inadequate data collected on how many hazardous leaks are found on COYLs on an annual basis. When hazardous leaks are found, Southwest Gas has the ability to make the situation safe by discontinuing gas service until the facility owner makes the necessary repairs.

66. Southwest Gas's provides illustrative cost scenarios for COYL repair but does not provide cost estimates based on evidence.

67. CPSD specifically indicated that out of all COYLs, school COYLs were their highest safety concern.

68. Southern California Gas Company offers a non-tariffed service for installation, maintenance, and service of gas facilities, including COYLs.

69. The Company's third infrastructure proposal relates to the accelerated replacement of AA pipe in its South Lake Tahoe jurisdiction.

70. AA is one of two pipe types in the Company's California service areas that the Company considers EVPP. AA pipe, unlike metal pipe, is prone to catastrophic failure, which can be induced by tree roots.

71. In 2007, the Company implemented a Company-wide EVPP replacement plan, which focuses on replacing plastic pipe installed from the late 1950s through the early 1980s, and has an anticipated completion date of 2026.

72. In December 2011, the PHMSA transmitted a letter to the Chairman of the NARUC, recommending that state public utility commissions consider accelerating work on certain types of high-risk infrastructure.

73. Plastic pipe manufactured in the 1960s to early 1980s is included on PHMSA's list for recommended high-risk infrastructure warranting accelerated work, and the March 2012 RAU report also cites AA pipe as the first of its 17 potential hazards.

74. As of August 2012, the Company had approximately 93,500 feet of known AA services and approximately 209,000 feet of AA mains in its South Lake Tahoe jurisdiction.

75. The Company proposes an additional attrition adjustment that would allow the Company to accelerate the replacement of AA pipe in South Lake Tahoe such that all such pipe will be replaced by 2018, rather than 2026.

76. Southwest Gas is not proposing the accelerated replacement of AA due to safety concerns.

77. Southwest has not provided compelling evidence to justify the accelerated replacement of AA pipe.

78. AA pipe replacement should not be taken out of context from an overall safety plan. The methodical replacement of AA pipe continues to be important to the Commission. The Company should continue its Company-wide EVPP replacement plan.

79. ORA agrees with the Company's billing determinants and Class Cost of Service Study, and accepts the Company's rate design methodology, as set forth in the Prepared Direct Testimony of Company witness Frank J. Maglietti, Jr. and Chapter 20 of the Company's Application.

80. ORA accepts the Company's proposals to establish a new rate schedule for special contract customer LUZ, and to make changes to the distribution shrinkage rate charged to transportation volumes. Said proposals are detailed in Mr. Maglietti's testimony.

81. The rate design portion of the Company's Application also includes proposals for two new rate mechanisms and changes to the Company's upstream pipeline and storage charge calculations.

82. The Company requests authority to change the calculation of its upstream pipeline and storage costs to an average rate calculation in order to simplify the calculation and enhance customer understanding. Currently, these rates are calculated using cold year and peak season throughput.

83. The Company requests approval of its California CEE Plan, which consists of CEE programs designed to provide and encourage opportunities for residential and commercial customers to experience reduced energy consumption and lower utility bills.

84. The CEE Plan will result in cost-effective energy savings and advance market transformation, thereby reducing the need for future market interventions. The Company proposes a \$5 million budget for the CEE Plan (\$1 million per year for 5 years), which will be recovered through the CEE surcharge.

85. ORA agrees with the Company's CEE Plan and the related budget and cost recovery.

86. Parties agree that the Company should be permitted to continue the ATM, and that the Company should implement certain modifications to the mechanism; those modifications include:

- (a) The benchmark rate and the measurement period for the ATM will be based on a twelve-month period, rather than the current six-month period;
- (b) The initial ATM benchmark will be established using the average for the twelve month period ended September 30, 2013 for the Moody's Baa Utility Bond Index. The ATM benchmark will remain in effect unless the ATM is triggered and a new benchmark rate is established. The Company will utilize the Moody's Baa Utility Bond index as the reference rate for the ATM, regardless of changes to its bond ratings, until the next general rate case or cost of capital proceeding; and

- (c) The specified criterion established for an off-ramp provision will be removed. Southwest Gas would have the right to file a cost of capital application outside of the ATM upon an extraordinary or catastrophic event that materially impacts its cost of capital and/or capital structure.

87. The Company and The Western Manufactured Housing Communities Association agree as to the Company's submetered space discount for each jurisdiction as follows: (a) Southern California - \$7.69; (b) Northern California - \$11.01; and (c) South Lake Tahoe - \$7.69.

88. Parties agree that the RO Model utilized in this proceeding should be updated to reflect all dollars, allocation methods, and other factors and percentages resulting from the Commission's final order.

Conclusions of Law

1. The record in this proceeding, including the written testimony from witnesses on behalf of ORA and the Company, multiple schedules for each ratemaking jurisdiction, and testimony and exhibits from three days of evidentiary hearings, demonstrates that the Company has satisfied its burden.

2. The Company's Application is in the public interest, proposed rate increases reasonable, and Application, should be approved, as modified by this decision.

3. The rates and charges set forth in the Application are just and reasonable and are supported by the evidence in the record; and that new rates should take effect upon effective date of this decision.

4. The Company's proposal to update gross plant and accumulated depreciation amounts for the Southern California and Northern California jurisdictions, as stipulated between the Company and ORA is reasonable and should be approved.

5. The Company's proposal to update gross plant and accumulated

depreciation amounts for the South Lake Tahoe jurisdiction is reasonable and should be approved.

6. The Company calculated its proposed lag days in a manner consistent with prior Commission decisions.

7. The Company's proposed methodology for arriving at the FIT and CCFT lag days is reasonable.

8. The Company's proposed five-year average materials and supplies forecast provides reasonably accurate reflection of the variability expected to be experienced by the Company when rates from this proceeding are in effect.

9. The Company's proposed use of a five-year average of past materials and supplies data is reasonable for all three of its California rate jurisdictions.

10. The Company's methodologies for projecting materials and supplies and customer advance balances are consistent, comprehensive and reasonable, and reasonably reflect the Company's anticipated experience with these accounts during the period that rates from this proceeding are in effect.

11. ORA's recommendations regarding the Company's deferred taxes and ORA's use of its unproven "scalar" factor to perform deferred tax calculations lack merit.

12. The Company's proposed deferred tax calculations are reasonable, as modified in this decision.

13. It is reasonable and appropriate to direct the Company to consistently apply 2013 bonus depreciation and adjust its deferred taxes to reflect 2013 bonus depreciation in all of its three California rate jurisdictions.

14. Consistent with the Commission's "stand-alone tax basis" policy, the Company's recalculated NOLs should be reflected in updated calculation of deferred taxes.

15. The Company's proposed deferred tax liability balances, as modified with its calculations of deferred tax liability adjustments for 2013 bonus depreciation, recalculated NOLs consistent with the Commission's "stand-alone tax basis" and net plant adjustments, are reasonable.

16. The uncollectibles percentages recommended by the Company are reasonable.

17. It is reasonable to authorize a PTYM adjustment for attrition years 2015-2018 in each of the Company's rate jurisdictions at 2.75 percent per year.

18. ORA's recommendation to phase-in any South Lake Tahoe rate increase over 20 percent is denied because the Company has adequately demonstrated that a phase-in based solely on the percent increase under the circumstance is unreasonable and inappropriate.

19. D.13-10-024 moots the Company's proposed recovery for VVTS; therefore, the Company's proposed recovery for VVTS should be denied.

20. The Commission should approve the capital structure, consisting of 55 percent common equity and 45 percent long-term debt.

21. It is reasonable to adopt a cost of capital proposal with common equity ratio of 55 percent and 10.10 percent ROE.

22. Common equity ratio of 55 percent is reasonably close to the Company's most current common equity figure of 54 percent and strikes a reasonable balance between those of the California energy utilities' capital structures (common equity ratio of 52 percent), ORA's proposed 51.7 percent, the Company's most current common equity figure of 54 percent and the Company's proposed 57 percent. A common equity ratio of 55 percent is also consistent with and within the Moody's target range.

23. 10.10 percent ROE is reasonable while still being consistent with the

Company's financial models, the national average and the Commission-authorized ROEs for other California energy utilities in D.12-12-034.

24. 10.10 percent ROE is reasonably supportive of the Company's improved credit ratings.

25. 10.10 percent ROE will produce overall rates of return that properly reflect the Company's business, financial and regulatory risks and will provide the Company a reasonable opportunity to earn a fair and reasonable return on its California distribution properties.

26. The Company should be authorized to earn a rate of return that is:
(a) commensurate with returns on investments in other firms having corresponding risks; (b) sufficient to assure confidence in the Company's financial integrity; and (c) sufficient to maintain the Company's creditworthiness and ability to attract capital on reasonable terms.

27. Consistent with the principles of future test year ratemaking, it is appropriate for the Commission to consider and adopt a capital structure that reflects the actual capital structure the Company is reasonably expected to achieve during the period that rates from this proceeding are in effect.

28. The capital structure authorized in this proceeding should consider the Company's expected capital structure in the period from 2014 through 2018.

29. The Company's requested capital structure is generally supported by evidence that: (1) the Company's capital structure has improved considerably since its last California general rate case; (2) the Company's proposed 57 percent common equity ratio is consistent with the overall projected common equity ratios for the proxy group; and (3) the Company's requested capital structure is also generally consistent with its target bond rating.

30. The Company's next general rate case should be filed in 2017 with a

2019 test year.

31. The Company's methodologies for forecasting distribution costs and customer accounts expenses are reasonable and should be approved.

32. The Company's methodology of consistently deriving its projected test year uncollectible rates from the applicable 2011 uncollectible rates is reasonable and should be approved.

33. The Company's methodologies for forecasting Injuries and Damages in Southern and Northern California jurisdictions, and for forecasting System Allocable Offices and Supplies, except as revised in this decision, are reasonable and should be accepted.

34. The Company's proposed balances for various administrative and general accounts – namely, Life and AD&D Insurance, Medical Insurance, EAP, EIP, Tuition Reimbursement, LTD, Employee Communications, and Miscellaneous Benefits are reasonable and should be adopted, except for FERC Account 921 which is revised for \$13,266,834.

35. The Company's positions, calculations and recommendations as to each of the Pension and Benefits expenses discussed in this decision are reasonable and supported by evidence, except as revised by this decision.

36. The Company's flex benefits account encompasses reasonable and necessary expenses and the Company's projected expenses included therein should be approved.

37. The Company's Executive Compensation analysis sponsored and its witness Sandra L. Gaffin is reasonable and undisputed.

38. It is reasonable for SERP and EDCP costs to be allocated 50/50 between ratepayers and shareholders.

39. ORA's labor loading rates are erroneously calculated.

40. The Company's proposed methodology for labor loading rates reflects the reasonable and appropriate parameters for calculating labor loading, and should be approved.

41. It is reasonable in light of the record to adopt a two-way balancing account for the Company's pension expenses

42. The depreciation rates contained in the Company's filed depreciation study is reasonable.

43. The Company's recommendation to update accumulated depreciation in the South Lake Tahoe jurisdiction, consistent with the agreed upon updates to the Southern California and Northern California jurisdictions between the Company and ORA, is reasonable and should be approved.

44. The effective tax rate should be used in computing the CCFT for ratemaking purposes.

45. The applicable calculation using the effective tax rate included in the Prepared Rebuttal Testimony of Company witness Ivan M. Holland should be approved.

46. ORA's calculation of the effective tax rate is incorrect.

47. The Company's proposed IRRAM is unsupported and should be modified to include the revised COYL program only.

48. The Company's COYL proposal is unreasonable in light of the record and inadequate data collected and should be modified.

49. A limited COYL program for leak detection surveys for schools is a reasonable investment by ratepayers.

50. According to Southwest Gas' Tariff Rule Nos. 16 and 19, Southwest Gas has no obligation to inspect or maintain facilities beyond the point of delivery, including COYLs which are owned, operated and maintained by the customer.

51. The COYL program is not legally required by state and federal laws. Southwest Gas has not demonstrated why the COYL program should be prioritized above a number of other safety recommendations.

52. A broad change in Commission policy regarding utility responsibility for equipment beyond the utility point of delivery is more appropriate in a rulemaking like R.11-02-019, where costs, benefits, and risks can be fully compared to other safety measure recommendations.

53. In D.14-03-021, the Commission approved a three-year pilot program to incentivize voluntary conversions from master-metered natural gas and electricity to direct utility service in mobile home parks and manufactured housing communities. Southwest Gas is subject to that decision and nothing in this decision affects D.14-03-021.

54. The Company's request for approval of its CEE Plan, including related budget and cost recovery, is reasonable, supported by evidence, in public interest and should be approved.

55. The Company's request for authorization to change the calculation of its upstream pipeline and storage costs to an average rate calculation is reasonable and should be approved.

56. The Company should be permitted to continue the ATM and should implement certain modifications to the mechanism, as follows:

- (a) The benchmark rate and the measurement period for the ATM will be based on a twelve-month period, rather than the current six-month period;
- (b) The initial ATM benchmark will be established using the average for the twelve month period ended September 30, 2013 for the Moody's Baa Utility Bond Index. The ATM benchmark will remain in effect unless the ATM is triggered and a new benchmark rate is established. The Company will utilize the Moody's Baa Utility Bond index

as the reference rate for the ATM, regardless of changes to its bond ratings, until the next general rate case or cost of capital proceeding; and

- (c) The specified criterion established for an off-ramp provision will be removed. Southwest Gas would have the right to file a cost of capital application outside of the ATM upon an extraordinary or catastrophic event that materially impacts its cost of capital and/or capital structure.

57. The Company's submetered space discount for each jurisdiction should be as follows: Southern California - \$7.69; Northern California - \$11.01; and South Lake Tahoe - \$7.69.

58. All issues raised by Application 12-12-024 and Protest filed by ORA are resolved by this decision, and all issues that have been stipulated, settled and otherwise agreed to by and between parties have been reviewed and, as settled, stipulated and otherwise agreed to, are deemed reasonable, consistent with applicable laws and in the public interest, as resolved.

59. All pending requests or motions, not expressly granted in this decision should be deemed denied.

60. A.12-12-024 should be closed, effective today.

O R D E R

IT IS ORDERED that:

1. The rate increases requested by Southwest Gas Corporation in the Application for Authority to Increase Rates and Charges for Gas Service in California, Effective January 1, 2014 (Application), filed on December 20, 2012, are approved, reflected in Attachment 1 to this decision and as modified by the Ordering Paragraphs below.

2. Southwest Gas Corporation is authorized to increase its base revenue requirement for test year 2014, as follows:

- (a) Increase of approximately \$1,872,515 or 1.8 percent from currently authorized revenue in its Southern California rate jurisdiction.
- (b) Increase of approximately \$2,514,501 or 8.4 percent from currently authorized revenues in its Northern California rate jurisdiction.
- (c) Increase of approximately \$2,716,370 or 13.7 percent from currently authorized revenues in its South Lake Tahoe rate jurisdiction.

3. Southwest Gas Corporation is authorized to implement the post-test year changes to rates and charges for years 2015 through 2018, to become effective on January 1 of each year, in each of its three California rate jurisdictions.

4. Southwest Gas Corporation shall implement the proposed Post Test Year Mechanism, proposed Infrastructure Reliability and Replacement Adjustment Mechanism and a Conservation and Energy Efficiency Plan, as directed in this Sections 5.2, 5.5, 5.6 and 5.7 of this decision.

5. Southwest Gas Corporation is authorized to update gross plant and accumulated depreciation amounts for its three California rate jurisdictions, as proposed.

6. Southwest Gas Corporation is authorized to use its proposed Federal Income Tax and California Corporate Franchise Tax lag days and methodology used.

7. Southwest Gas Corporation shall use a five-year average of past materials and supplies data in all three of its California rate jurisdictions.

8. Southwest Gas Corporation shall use its projection of materials and supplies and proposed customer advance balances, as proposed.

9. Southwest Gas Corporation's proposed deferred tax liability balances, as

modified with its calculations of deferred tax liability adjustments for 2013 bonus depreciation, recalculated net operating losses consistent with the Commission's "stand-alone tax basis" and net plant adjustments, are approved.

10. Southwest Gas Corporation shall adjust its deferred taxes to reflect 2013 bonus depreciation in all of its three California rate jurisdictions.

11. Southwest Gas Corporation shall use the proposed Gross Revenue Conversion Factor, as proposed.

12. Southwest Gas Corporation's post-test year margin (PTYM) adjustment for attrition years 2015-2018 in each of its rate jurisdictions shall be based on the 2.75 percent per year PTYM adjustment that is currently in place.

13. Southwest Gas Corporation's proposed cost recovery, in the form of a second attrition adjustment applicable to its South Lake Tahoe jurisdiction, for Southwest Gas's proposed acceleration of Aldyl-A pipe replacement project in South Lake Tahoe is denied.

14. Southwest Gas Corporation's request that the actual Commission approved amount for Victor Valley Transmission System replacement project in Rulemaking 11-02-019 be fully reflected in its rates by the year 2015 is denied.

15. Southwest Gas Corporation's proposed cost recovery for a portion of the dollars associated with its Victor Valley Transmission System replacement through its first Post Test Year Mechanism is denied.

16. Southwest Gas Corporation's proposed capital structure, consisting of 57 percent common equity and 43 percent long-term debt is denied.

17. Southwest Gas Corporation's common equity ratio shall be 55 percent and the return on common equity shall be 10.10 percent.

18. Southwest Gas Corporation shall file its next general rate case by September 1, 2017 with a 2019 test year.

19. Southwest Gas Corporation's methodologies for forecasting distribution costs and customer accounts expenses are approved.

20. Southwest Gas Corporation's methodology of consistently deriving its projected test year uncollectible rates from the applicable 2011 uncollectible rates is approved.

21. Southwest Gas Corporation's methodologies for forecasting Injuries and Damages in Southern and Northern California jurisdictions, and for forecasting System Allocable Offices and Supplies, except as revised in this decision, are approved.

22. Southwest Gas Corporation's proposed balances for various administrative and general accounts – namely, Life and Accidental Death and Disbursement Insurance, Medical Insurance, Employee Assistance Plan, Employee Investment Plan, Tuition Reimbursement, Long Term Disability, Employee Communications, and Miscellaneous Benefits are adopted, except for Federal Energy Regulatory Commission Account 921 which is revised to \$13,266,834.

23. Southwest Gas Corporation's calculations and recommendations as to each of the Pension and Benefits expenses discussed in this decision are adopted, with two exceptions. The costs for the Supplemental Executive Retirement Plan and the Executive Deferred Compensation Plan shall be allocated 50 percent to shareholders and 50 percent to ratepayers in cost of service, and a two-way balancing account for pension expenses is adopted.

24. Southwest Gas Corporation's flex benefits account and the Company's projected expenses included therein are approved.

25. Southwest Gas Corporation's proposed methodology for labor loading rates is approved.

26. The depreciation rates contained in the Southwest Gas Corporation's filed depreciation study are adopted.

27. Southwest Gas Corporation's recommendation to update accumulated depreciation in the South Lake Tahoe jurisdiction, consistent with the agreed upon updates to the Southern California and Northern California jurisdictions between the Company and Office of Ratepayer Advocates, is approved.

28. In computing the California Corporate Franchise Tax for ratemaking purposes, the calculation using the effective tax rate included in the Prepared Rebuttal Testimony of Southwest Gas Company witness Ivan M. Holland is approved.

29. Southwest Gas Corporation's proposed Infrastructure Reliability and Replacement Adjustment Mechanism, to provide means of recovering the revenue requirement associated with non-revenue producing infrastructure projects authorized by the Commission, is reduced to \$8,648 for the revised Customer-Owned Yard Line program only.

30. Southwest Gas Corporation's Customer-Owned Yard Line program proposal is modified to include only leak detection surveys for the 259 schools proposed.

31. Southwest Gas Corporation's proposal to accelerate the Aldyl-A pipe replacement project in South Lake Tahoe, is denied.

32. Southwest Gas Corporation's California Conservation and Energy Efficiency Plan, including related budget and cost recovery, is approved, and Southwest Gas Corporation shall establish the appropriate customer surcharge.

33. Southwest Gas Corporation's request for authorization to change the calculation of its upstream pipeline and storage costs to an average rate calculation is approved.

34. Southwest Gas Corporation shall continue its use of the Automatic Trigger Mechanism (ATM), with following modifications to the mechanism:

- (a) The benchmark rate and the measurement period for the ATM will be based on a twelve-month period, rather than the current six-month period;
- (b) The initial ATM benchmark will be established using the average for the twelve month period ended September 30, 2013 for the Moody's Baa Utility Bond Index. The ATM benchmark will remain in effect unless the ATM is triggered and a new benchmark rate is established. The Company will utilize the Moody's Baa Utility Bond index as the reference rate for the ATM, regardless of changes to its bond ratings, until the next general rate case or cost of capital proceeding; and
- (c) The specified criterion established for an off-ramp provision will be removed. Southwest Gas would have the right to file a cost of capital application outside of the ATM upon an extraordinary or catastrophic event that materially impacts its cost of capital and/or capital structure.

35. Southwest Gas Corporation's submetered space discount for each jurisdiction shall be as follows: (a) Southern California - \$7.69; (b) Northern California - \$11.01; and South Lake Tahoe - \$7.69.

36. Southwest Gas Corporation is authorized to submit an advice letter and revised tariff schedules consistent with this decision. This advice letter shall comply with General Order 96 and be reviewed by the Commission's Energy Division. The effective date of the revised schedules, if approved by Energy Division, shall be the effective date of this decision and apply only to service rendered on or after the effective date.

37. Southwest Gas Corporation is authorized to submit advice letters requesting attrition year adjustments to rates for 2015 through 2019 consistent with this decision. Supporting work papers shall be included with the advice

letters.

38. Any and all pending motions and requests in this proceeding and/or requests made in Application 12-12-024 and protest filed by Office of Ratepayer Advocates are deemed denied, except as expressly granted in this decision.

39. Application 12-12-024 is closed.

This order is effective today.

Dated _____, at San Francisco, California.